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Comparison of Consumer Rates in Direct and Indirect Markets

[redacted]

CFPB Office of Research

Note: This document was used in support of a live discussion. As such, it does not necessarily express the entirety of that discussion nor the relative emphasis of topics therein.

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NADA claims that consumers receive better rates through indirect versus direct markets

- Evaluation of the claim involves understanding the empirical basis
  - NADA relies on unbalanced statistics to make this argument
- Alternative analysis suggests results to the contrary
  - Analysis of one lender's direct and indirect portfolio suggests that indirect borrowers pay more than they would had they received a direct loan
  - After controlling for credit characteristics, it appears average rates are higher in indirect lending, and substantially higher for subprime borrowers
  - NADA's result may be driven by differences in credit across groups and non-comparable loans, not market conditions that improve consumer outcomes

NADA provides calculations to illustrate rates are lower in indirect compared to direct

- How are these numbers calculated?
  - Commercial banks: Unweighted average of “most common rate charged” for 48-month new car loan (reported by banks to Fed)
  - Dealers: Average of rates across all credit tiers, excludes captives, includes subvention loans

	2008	2009	2010
Commercial banks[9]	7.02%	6.72%	6.21%
Dealers[10]	6.25%	5.50%	4.40%
Average Consumer Savings:	0.77%	1.22%	1.81%

NADA approach is flawed

- Previous table is less apples to apples, more apples to pears (kind of close, but…). Key issues include:
  - Bank calculation would count a community bank with 5 loans the same as a top 5 lender ([redacted])
  - Even non-captives have significant numbers of subvention loans; average dealer rate also includes range of term lengths

- An alternative approach would be to compare direct and indirect portfolios inside one lender, and then control for differences in observable characteristics across the two groups
  - Controlling for these differences will generate more comparable rates across the two lending channels

Data from one lender can help facilitate an appropriate comparison

- Approx. [redacted] non-subvented, non-captive, purchase loans
  - Span [redacted]
  - [redacted] indirect, [redacted] direct
  - Includes significant amount of both prime and subprime lending
  - Company uses same internal scoring across both direct and indirect portfolios
  - We have pricing sheets used in both types of lending that can be used to model outcomes

Actual rates in indirect are lower than actual rates in direct for prime borrowers

- Comparing ACTUAL loans within each channel
- Indirect rates actually are lower for prime consumers
- But indirect customers both have better FICO and proprietary scores
- Other characteristics are similar

	Prime		
	Direct	Indirect	Diff.
APR (%)	6.3	4.8	1.57
System Buy Rate (%)	-	3.6	-
FICO	699.65	766.55	-66.90
Proprietary Score	[redacted]	[redacted]	[redacted]
Loan Amt.	$21,027	$21,173	-$145
LTV (%)	96	91	6
PTI (%)	8	7	1
Term	63	62	.85
Obs.	[redacted]	[redacted]	

Actual rates in indirect are higher than actual rates in direct for subprime borrowers

- Comparing ACTUAL loans within each channel
- For subprime, direct consumers receive lower rates than indirect
- In this case, direct customers have better credit characteristics than indirect
- Other characteristics are relatively similar

	Subprime		
	Direct	**Indirect**	**Diff.**
APR (%)	12.2	16.1	-3.93
System Buy Rate (%)	-	14.9	-
FICO	609.80	595.44	14.36
Proprietary Score	[redacted]	[redacted]	[redacted]
Loan Amt.	$19,740	$18,484	$1,256
LTV (%)	103	112	-9
PTI (%)	10	11	-1
Term	65	68	-3
Obs.	[redacted]	[redacted]	

Differences in actual rates are likely due to differences in the characteristics of borrowers and loans

- Since direct and indirect customers look different, informative to estimate what rates indirect customers would have gotten had they gone through the direct channel
  - How does this rate compare to the actual APR the customers receive?
  - How does this rate compare to the buy rate generated before dealer relationships and markup are included?
- Need some way to categorize customers into credit groupings comparable across direct and indirect
  - Done two different ways; both show similar outcomes

Indirect rates are actually higher than direct rates for similarly situated prime borrowers

	Diff. (Indirect Only) Actual APR - Est. APR, bp	Diff. (Indirect Only) Buy Rate - Est. APR, bp
Prime Credit Only		
Est. APR (Structured Tiers)	32***	-87***
	(0.00)	(0.00)
Est. APR (Banded Tiers)	20***	-98***
	(0.00)	(0.00)

Note: Adj. R^2 (Banded): 0.89, Adj. R^2 (Structured): 0.88
Controls used in regression included proprietary score, FICO, term, vehicle age and make, loan amount, application source, flags for prior bankruptcies and repossessions, and state and month fixed effects

- Either estimation type provides the same result: actual indirect APRs are 20-32 basis points higher than the rate similarly situated prime customers would have gotten through the direct channel
  - Interestingly, the buy rates are lower than the direct rate, hinting that the current market structure leaves space for dealers to go below the direct rate for sophisticated consumers

Indirect rates remain higher than direct rates for similarly situated subprime borrowers

	Diff. (Indirect Only) Actual APR - Est. APR, bp	Diff. (Indirect Only) Buy Rate - Est. APR, bp
Subprime Credit Only		
Est. APR (Structured Tiers)	237***	112***
	(0.00)	(0.00)
Est. APR (Banded Tiers)	214***	90***
	(0.00)	(0.00)

Note: Adj. R^2 (Banded): 0.89, Adj. R^2 (Structured): 0.88
Controls used in regression included proprietary score, FICO, term, vehicle age and make, loan amount, application source, flags for prior bankruptcies and repossessions, and state and month fixed effects

- For subprime, actual indirect APRs are 214-237 basis points higher than the rate similarly situated subprime customers would have gotten through the direct channel
  - In this channel, the buy rates are higher, as well

Analysis of one institution may not reflect market wide rate outcomes

- This result is generated using loans from only one lender
  - With that said, lender has better coverage across lending types than many others
- Could use AutoCount (procured by ILLM) to replicate result using a different lender
  - Results could be discussed openly
  - However, structure of data involves additional challenges