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Auto Finance Discrimination Working Group Discussion

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Consumer Financial Protection Bureau

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FEDERAL INTERAGENCY JURISDICTION

Entity	Supervision	Enforcement	Rulemaking
BHPH	CFPB*	CFPB/FTC/DOJ	CFPB
Exempt Auto Dealers	-	FTC/DOJ	FTC/FRB
Non Bank (Captive & Non-Captive)	CFPB*	CFPB/FTC/DOJ	CFPB
Bank > $10 Billion (& affiliates)	CFPB	CFPB/DOJ	CFPB
Bank < $10 Billion	Prudential Regulators	DOJ	CFPB

ECOA Application to Indirect Auto Lenders

- ECOA prohibits discrimination by a creditor with respect to any aspect of a credit transaction, 15 U.S.C. § 1691(a)(1)
- ECOA defines "creditor" as "any person who regularly extends, renews, or continues credit; any person who regularly arranges for the extension, renewal, or continuation of credit; or any assignee of any original creditor who participates in the decision to extend, renew or continue credit." 15 U.S.C. § 1691a(e)
  - "Creditor" is further defined in Reg B - any "person who, in the ordinary course of business, regularly participates in a credit decision, including setting the terms of credit." 12 C.F.R. § 202.2(l)
- Lenders set the terms and conditions by which they will buy the loan from the dealer – establishing parameters for the terms of credit, which includes allowing dealers to markup the interest rate
- Indirect lenders are legally responsible under ECOA if dealer markups have a discriminatory effect -- see comparable actions regarding broker yield spread premiums

Compensation and Need for Industry Wide Solution

- Current Compensation Structures
  - Dealer reserve or participation with a cap
  - Flat fee based on contract terms or type
  - Subvented (captive or special relationship only)
  - Uncapped dealer reserve or participation with "savvy" consumers able to negotiate

- Even within capped reserve schema, discrimination can and does happen

- Banks and non-banks must be part of the same system
  - Contract assignment will be driven by dealers to revenue maximizing opportunities

Fair Lending Supervisory Exams

- [redacted] Currently Scheduled Exams: [redacted]

[redacted]

- If discrimination is found, possible corrective actions include:
  - Citing violations
  - Requiring remediation, assessing penalties
  - Prospective relief*
  - Enforcement actions
  - DOJ Referrals
- Sanctions would principally apply to bank participants

Need for a Revised Industry Compensation Paradigm

- Flat fee
  - An improvement but can still result in dealer/consumer alignment issues
  - Inter-lender steering versus intra-lender markup
- Competition amongst lenders to contain inter-lender steering
  - Competition will need a boost even with flat fees
  - Competition may work if
    - Dealer gets paid for pre-financed buyer, has less incentive to steer for the last few basis points
    - Dealer can move more metal at a lower rate
- CFPB could choose to add
  - Major consumer education piece off regulatory actions: "is that my best rate?"
  - Promotion of robust refinance market
  - Promotion of innovation with regard to direct loan delivery

Tools for Addressing Contract Originator Compensation

Leveling the playing field -- issues of timing and inconsistent outcomes

- Confidential supervisory processes with banks coupled with public enforcement actions for non-banks
  - Risks: Difficulty coordinating timing of supervisory and enforcement actions; possible inconsistent outcomes if litigated

- Data submission, analysis and industry wide mandatory change: public report, ANPR, and supervisory guidance while already-initiated supervisory actions play out
  - Risks: Ability to get voluntary data and sufficient breadth in sample to find evidence consistent with supervisory outcomes

Reaction of Dealer Base to Revenue Threat

- NADA reaction would depend on average level of flat fees
  - Flat fee should clear in market competition at level equal to today's average markup

- Changing a major method of compensation could cause movements in other variables as dealers look to recoup lost profitability
  - Retail Vehicle Prices
  - Interest Rate (APR)
  - Loan to Value (LTV)
  - Excess Spread
  - Cost of Funds
  - Credit Loss
  - Add-on Product Penetration and/or Mark-up

Expected Movement of Select Variables

- Retail Vehicle Prices – increase to compensate for lost finance margin; limited on the new car side due to price transparency
- Interest Rate (APR) – may increase across the board over what initial buy rates would have been; should decrease for consumers who may have been marked up the most; dollar weighted average may remain unchanged
- Loan to Value (LTV) – initial LTV may increase if retail price is increased to compensate for loss of finance income
- Excess Spread – moves lock-step with APR; less excess spread may require additional credit enhancement for ABS trusts; no impact to capital
- Lender Cost of Funds – no change on balance sheet; reduced excess spread could extend weighted average life off balance sheet increasing cost of funds
- Credit Loss – should decrease as lower APR for borrowers who are "on the margin" cause fewer or less severe defaults; higher overall APR's could drive more borrowers "to the margin"
- Add-on Product Penetration and/or Mark-up – should increase as dealers seek to mitigate lost upfront finance income; may pressure LTV's as well