

# Indirect Auto Lending – Fair Lending Considerations

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*Consumer Financial Protection Bureau  
Federal Reserve Board  
U.S. Department of Justice*

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# Overview

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- **Indirect Auto Lending and Compliance with the Equal Credit Opportunity Act**
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- **Federal Reserve Fair Lending Examinations**
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- **Questions**
- **Resources and Appendix**

# Indirect Auto Lending and Compliance with the Equal Credit Opportunity Act

*Patrice Ficklin, Fair Lending Director  
Consumer Financial Protection Bureau*

# CFPB Topics

- CFPB Authority
- Indirect Auto Lending
- Discretion and Fair Lending Risk
- How to Comply

# CFPB Supervisory Authority

## Large Banks

- Authority to supervise banks, thrifts and credit unions with over \$10 billion in assets (as well as their affiliates and certain service providers) to assess their compliance with Federal consumer financial law, evaluate their compliance management systems, and detect and assess risks to consumers and markets for consumer financial products and services.

## Nonbanks

- Authority to supervise certain nonbank consumer financial services companies. CFPB's nonbank supervision authority includes all mortgage originators, mortgage servicers, private education lenders, and payday lenders.
- Authority to supervise nonbanks that are "larger participants" in other markets for consumer financial products or services, as defined by rule.
- Authority to supervise other nonbank covered persons the Bureau finds are engaged or have engaged in conduct that poses a risk to consumers with regard to consumer financial products or services.

# CFPB Enforcement Authority

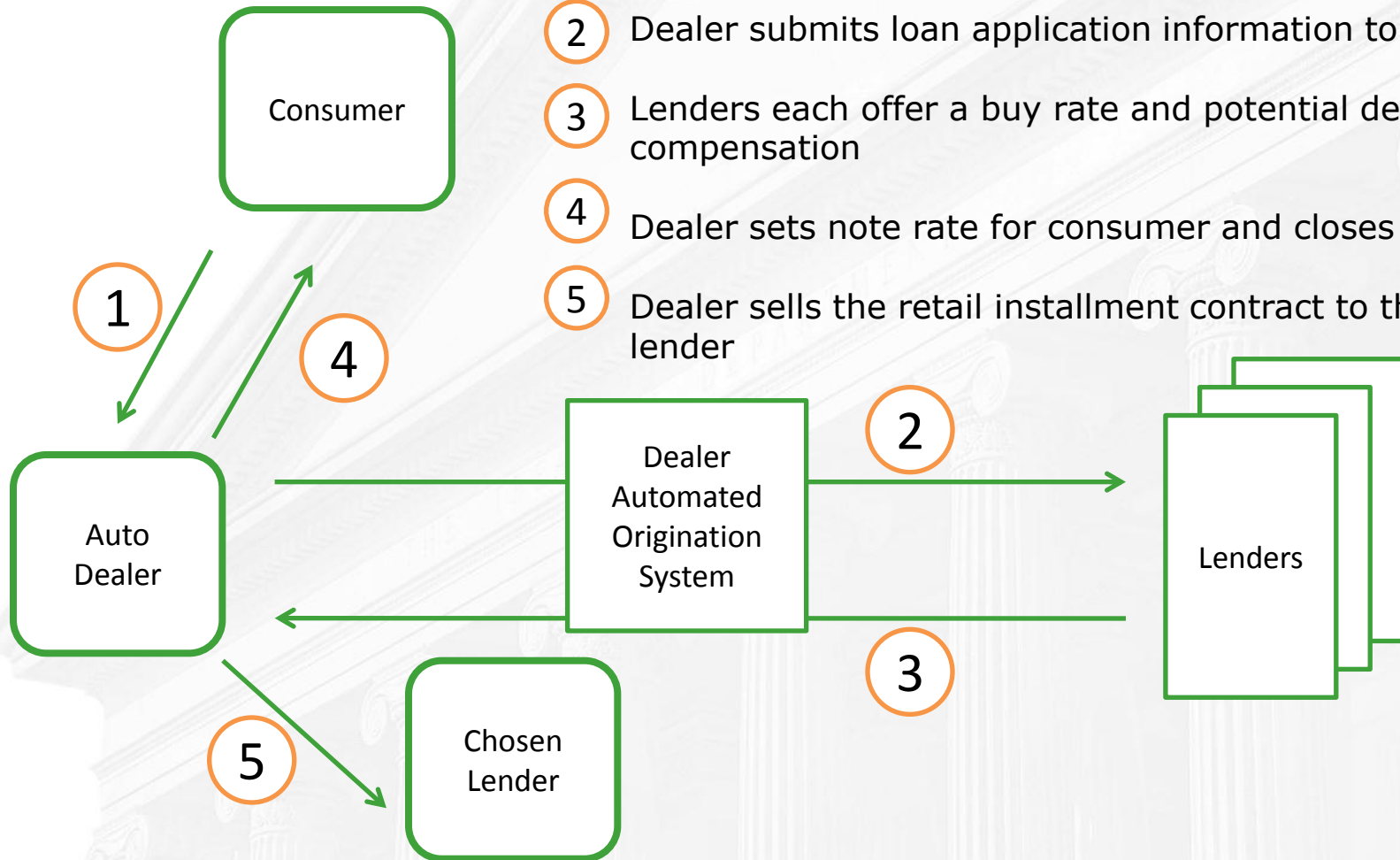
- The CFPB has enforcement authority over those who violate federal consumer financial laws, subject to certain restriction
- This includes authority over those who offer or provide consumer financial products or services and extends to nonbanks that are not subject to the CFPB's supervisory jurisdiction

# CFPB Auto Compliance Bulletin

- [CFPB Bulletin 2013-02, Indirect Auto Lending Compliance with the Equal Credit Opportunity Act](#)
- The Bureau's Indirect Auto Lending Bulletin:
  - Explains that the standard practice of indirect auto lenders likely make them “creditors” under ECOA;
  - Explains that a lender's discretionary markup and compensation policies may alone be sufficient to trigger liability under ECOA; and
  - Explains how indirect auto lenders can mitigate the risk of discrimination resulting from dealer markup and compensation policies

# Typical Indirect Auto Finance Process

- 1 Consumer submits loan application (income, creditworthiness, auto price, trade-in, etc.)
- 2 Dealer submits loan application information to lenders
- 3 Lenders each offer a buy rate and potential dealer compensation
- 4 Dealer sets note rate for consumer and closes the sale
- 5 Dealer sells the retail installment contract to the chosen lender





# Indirect Auto Lenders Likely “Creditors” Under ECOA

- ECOA’s definition of creditors is quite broad
- Creditors are those who regularly participate in a credit decision, including setting the terms of the credit
- The standard practices of indirect auto lenders likely constitute participation in a credit decision

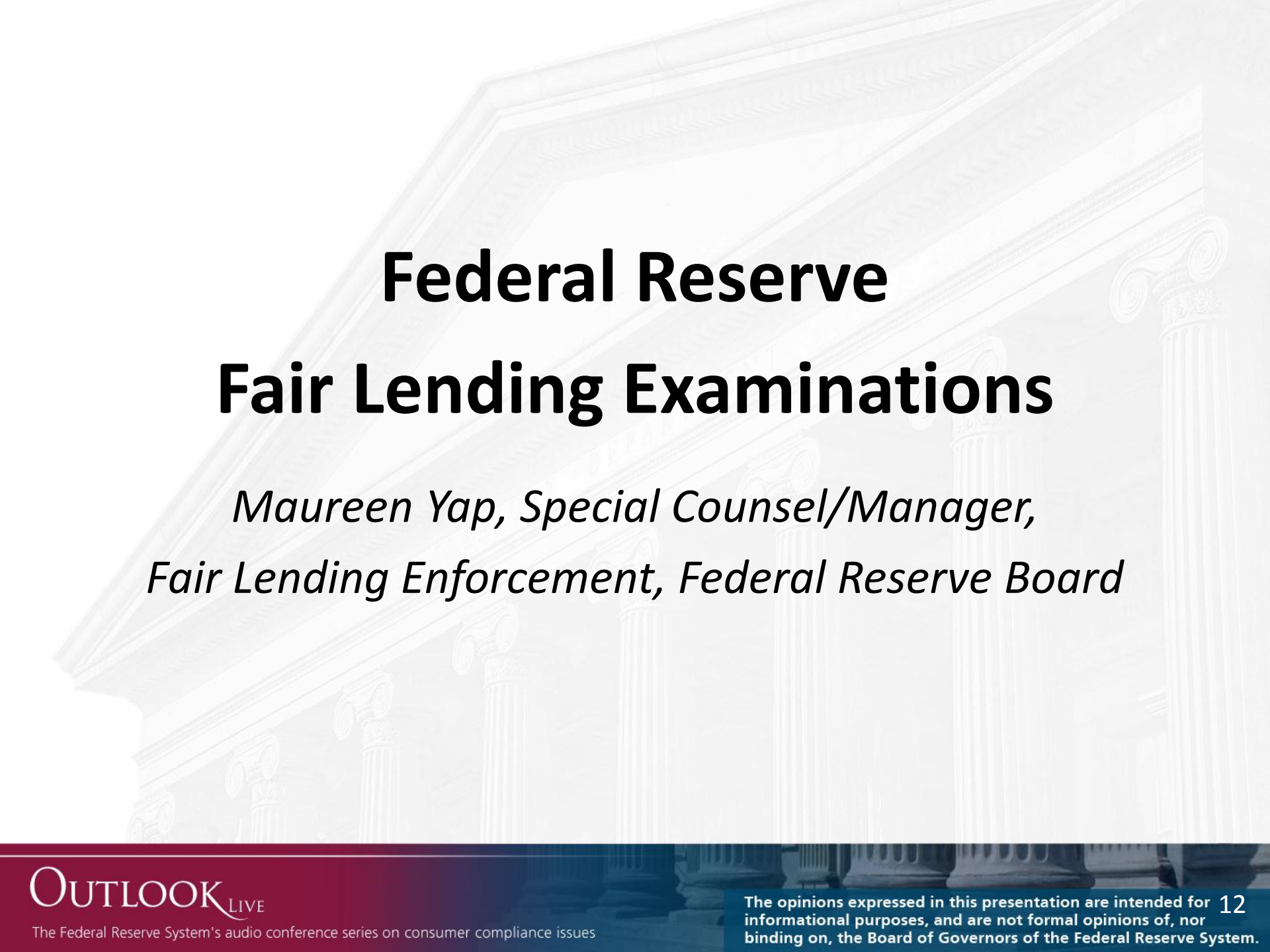
# Dealer Markup and Fair Lending Risk

- Allowing dealers discretion to increase consumer interest rates is a source of fair lending risk
- Prior litigation and research indicate that dealer markup may result in disparities on the basis of race, national origin, and potentially other prohibited bases
- Markup policies resulting in dealer-level or portfolio-wide disparities on prohibited bases could violate ECOA

# How to Comply?

Steps to ensure compliance might include:

- Imposing controls on dealer markup and compensation policies, or otherwise revising dealer markup and compensation policies, and also monitoring and addressing the effects of those policies (through dealer communications, regular analysis, prompt corrective action, and consumer remuneration) so as to address unexplained pricing disparities on prohibited bases; or
- Eliminating dealer discretion to mark up buy rates and fairly compensating dealers using another mechanism, such as a flat fee per transaction, that does not result in discrimination



# Federal Reserve

## Fair Lending Examinations

*Maureen Yap, Special Counsel/Manager,  
Fair Lending Enforcement, Federal Reserve Board*

# Federal Reserve

## Fair Lending Examinations

- *Does the Federal Reserve examine state member banks for fair lending risk in indirect auto lending?*
  - Examiners review fair lending risk based on the 2009 Interagency Fair Lending Examination Procedures
  - 2009 DOJ case based on Federal Reserve referral
  - Federal Reserve's ECOA authority limited to state member banks below \$10 billion

# Federal Reserve

## Fair Lending Examinations *(cont'd)*

- *How will the Federal Reserve examine for fair lending risk in indirect auto lending?*
  - Based on 2009 Interagency Fair Lending Examination Procedures
  - Examiners will look for the following risk factors:
    - Complaints
    - Policies or procedures that indicate discretion in pricing and/or exceptions
    - Compensation based on the terms or conditions of the loan
    - Loan data that indicate pricing disparities on a prohibited basis

# Federal Reserve

## Fair Lending Examinations *(cont'd)*

- *How does the Federal Reserve determine borrowers' race, ethnicity, and gender?*
  - Race/ethnicity: Geocode loans to determine majority minority census tract
  - Compare pricing of loans in majority minority census tracts vs. loans in non-majority minority census tracts
  - Not a proxy; conduct comparison by racial/ethnic composition of the neighborhood

# Federal Reserve

## Fair Lending Examinations *(cont'd)*

- *How does the Federal Reserve determine borrowers' race, ethnicity, and gender (cont'd)?*
  - Ethnicity (Hispanic): Code surnames of borrowers based on U.S. Census list of common Spanish surnames
  - Compare pricing of Hispanics loans vs. non-Hispanic loans



# Federal Reserve

## Fair Lending Examinations *(cont'd)*

- *How does the Federal Reserve determine borrowers' race, ethnicity, and gender (cont'd)?*
  - Gender: Code first names of single borrowers based on U.S. Census list of common female and male first names
  - Compare pricing of single female loans vs. single male loans
  - See Appendix for step-by-step process to code loans for ethnicity and gender using Excel

# Federal Reserve

## Fair Lending Examinations *(cont'd)*

- *What does the Federal Reserve typically do if it finds evidence of pricing disparities?*
  - Ask the bank about pricing criteria
  - May review loans files for potential pricing criteria and explanations
  - Request data related to pricing criteria
  - Explain findings and provide an opportunity for the bank to respond

# Federal Reserve

## Fair Lending Examinations *(cont'd)*

- *What advice does the Federal Reserve have for mitigating fair lending risk?*
  - Review and address complaints regarding potential pricing discrimination
  - Review policies, procedures, rate sheets, and dealer agreements to determine the level of discretion provided in loan pricing
  - Review dealer agreements to determine whether financial incentives are based on the price of the loans
  - Provide training to relevant parties

# Federal Reserve

## Fair Lending Examinations *(cont'd)*

- *What advice does the Federal Reserve have for mitigating fair lending risk (cont'd)?*
  - If there is elevated risk and sufficient volume, conduct a statistical analysis of the loans. The analysis should review loans:
    - By majority minority census tract, ethnicity, and gender
    - With mark-ups, with negative mark-ups, and with no mark-ups together
    - Within dealers and across dealers
    - On a rolling periodic basis
  - Address any unexplained disparities

# DOJ Auto Lending Enforcement

*Coty Montag, Deputy Chief  
Housing and Civil Enforcement Section  
Civil Rights Division  
U.S. Department of Justice*

# Jurisdiction under ECOA

- Basic framework of ECOA
- Attorney General can file suit if he has reasonable cause to believe that the proposed defendants have engaged in a “pattern or practice” of discrimination
- Lawsuit can arise from agency referral or independent pattern or practice authority
- DOJ annually files report with Congress on its activities under the statute

# Auto Lending Enforcement

- *United States v. Nara Bank and Union Auto Sales* (C.D. Cal.)
- *United States v. Pacifico Ford, Inc.* (E.D. Pa.)
- *United States v. Springfield Ford, Inc.* (E.D. Pa.)
- *Amicus* brief in *Cason v. Nissan Motor Acceptance Corp.* (M.D. Tenn.)

# *Nara Bank*

- Complaint alleged that Nara Bank and dealerships charged non-Asian customers higher overages or markups than similarly-situated Asian customers
- Partial consent decree resolving claims against Nara Bank in 2009
- Proposed agreed order resolving pricing claim against one dealer filed on July 16, 2013



# *Pacifico and Springfield*

- Complaints alleged that Philadelphia-area car dealerships charged African-Americans higher interest rate markups
- Dealers were granted broad and subjective discretion by lenders to mark up buy rate
- No formal, uniform underwriting procedures to set interest rate markups
- Lenders gave dealers incentives for markup

# Ongoing Enforcement Efforts

- Focus on race-based targeting by “buy here-pay here” auto dealers
- Focus on discrimination in discretionary markups and fees in auto lending, including several investigations being conducted jointly with the CFPB

# Contact Information

Coty Montag, Deputy Chief  
Housing & Civil Enforcement Section

Civil Rights Division

U.S. Department of Justice

202-305-0122

[coty.montag@usdoj.gov](mailto:coty.montag@usdoj.gov)

[www.justice.gov/fairhousing](http://www.justice.gov/fairhousing)

# Resources

- [2013 CFPB Bulletin re Indirect Auto Lending](#)
- [CFPB ECOA Baseline Review Procedures](#)
- [CFPB ECOA Targeted Review Procedures](#)
- [2009 Interagency Fair Lending Examination Procedures](#) and [Appendix](#)
- [DOJ Cases and Amicus Brief](#)
  - *U.S. v. Nara Bank and Union Auto Sales*
  - *U.S. v. Pacifico Ford*
  - *U.S. v. Springfield Ford*
  - *Cason v. Nissan Motor Acceptance*

# Appendix: Federal Reserve

## Coding for Ethnicity and Gender

- Federal Reserve's Step-by-Step Guide to Coding for Gender and Ethnicity
- Federal Reserve's Example: Hypothetical Loan Data with Lookups and Formulas
- Federal Reserve's Female and Hispanic Names List (U.S. Census)

# Questions

