

Fair Lending Myths vs. Facts - April 26, 2018

Support S.J.Res. 57 To Rescind the CFPB's Flawed Indirect Auto Lending Guidance

Myth One

The goal of S.J.Res. 57, a resolution that would disapprove the Consumer Financial Protection Bureau's (CFPB) 2013 indirect auto lending guidance, is to prevent the CFPB from enforcing anti-discrimination laws in auto lending.

Facts

The goal of S.J.Res. 57 is to affirm Congressional policymaking authority and disapprove the CFPB's 2013 auto lending guidance that attempts to change the \$1.1 trillion-dollar auto loan market.

This resolution in no way amends fair credit laws or hinders their enforcement. Rather, it simply rescinds the CFPB's 2013 guidance and will not preclude enforcement of the Equal Credit Opportunity Act (ECOA). The resolution is similar to H.R. 1737, the "Reforming CFPB Indirect Auto Financing Guidance Act", H.R. 1737, which would have rescinded the guidance and passed the House in 2015 by a bipartisan vote of 332-96, including 88 Democrats. The minority views included in the House Financial Services Committee Report accompanying H.R. 1737 [H. Rept. 114-329] stated that "H.R. 1737 does not alter regulated entities' obligations under the Equal Credit Opportunity Act (ECOA) or the CFPB's examination or enforcement activity pursuant to ECOA."

Auto dealers take fair credit seriously, and all national dealer associations are firmly committed to promoting strong fair credit compliance through a robust voluntary fair credit compliance program. Based on a Department of Justice (DOJ) model, the program addresses fair credit risk while permitting dealers to discount rates for consumers for legitimate business reasons. Every customer, of every race, deserves to be treated fairly, and there is no place for discrimination in the auto retailing business. Any suggestion that S.J.Res. 57 harms fair lending is unfair, baseless, and wrong.

Myth Two

Studies demonstrate that the indirect auto lending market results in overcharges and fair lending problems.

Facts

The Washington Post fully debunked the primary report cited in support of the Center for Responsible Lending's (CRL) claim that dealer compensation "cost[s] consumers \$26 billion a year." The Post found CRL's conclusions were based on misapplied, unexplained, and false data and gave the claim 4 Pinocchio's – their maximum rating (a "Whopper") for a false statement.¹ Far from constituting a "bonus" or "overcharge," the compensation that a dealer receives for assisting in the arrangement of financing is just the retail return on its investments for costs related to serving as the "storefront" for banks, credit unions, etc. (including items such as dealer finance staff, software, overhead, etc.). In fact, a dealer's access to many lenders vying to provide financing to consumers often provides car buyers with better finance rates than they could get on their own.

¹ Glenn Kessler, *Warren's false claim that 'auto dealer markups cost consumers \$26 billion a year,* WASHINGTON POST, May 5, 2015.

A prominent research firm reviewed more than 8.2 million auto loan records and released a study of CFPB's claim that a discounted interest rate creates a fair-credit risk; this study revealed that CFPB's analysis was "conceptually flawed and subject to significant bias and estimation error." The Charles River Associates study found that the CFPB's findings of variations in interest rates were significantly overstated and failed to consider legitimate and lawful factors, such as budget constraints and competing offers, which explain why a dealer may discount an interest rate and why prices vary from consumer to consumer.²

In contrast to comprehensive studies that have reviewed auto lending, critics of S.J.Res. 57 rely on a recent National Fair Housing Alliance's study (promoted by CRL) that attempts to draw unsubstantiated conclusions from sixteen cherry-picked auto shopping interactions, not completed sales transactions, in a market where 17 million actual sales occur annually. Such an insignificant sample size clearly deprives the "study" of any statistically relevant significance, and the methodology of the study is not sufficiently explained to warrant specific conclusions about the price of financing. Finally, the study did not use identically situated test subjects with debt to income ratios, incomes, etc.³

Myth Three

The settlement of some CFPB enforcement actions by certain auto lenders is proof of general wrongdoing in the industry.

Facts

CFPB enforcement actions forced lenders to settle based on flawed information and analysis. In issuing its 2013 guidance, the CFPB used a flawed method for identifying the background of consumers since its analysis was based solely on a borrower's zip code and last name. A non-partisan study of the CFPB's methodology found a 41% error rate for classifying the background of a significant group of consumers. Even the CFPB's own review revealed a 20% error rate for the same group.⁴

The CFPB is a powerful regulator with tremendous leverage over lenders and settlements. For example, CFPB internal documents show that the agency sought to reach a settlement with one lender – Ally – because the CFPB felt that Ally "may have a powerful incentive to settle the entire matter quickly without engaging in protracted litigation."⁵ Specifically, the lender needed approval of its pending application to become a financial holding company from the federal government.⁶ Three days after the lender's consent order with the CFPB, the federal government approved the lender's application.

² Charles River Associates, *Fair Lending: Implications for the Indirect Auto Finance Market* at 4 (Nov. 2014).

³ A correct fair lending analysis must identify and compare similarly situated consumers by holding constant variables such as the amount financed; trade-in value; competition in the local market; market conditions; demand and desirability for the vehicle; the consumer's payment capacity; and whether the car is new or used.

⁴ USING PUBLICLY AVAILABLE INFORMATION TO PROXY FOR UNIDENTIFIED RACE AND ETHNICITY: A METHODOLOGY AND ASSESSMENT (2014). https://files.consumerfinance.gov/f/201409_cfpb_report_proxy-methodology.pdf

⁵ COMMITTEE ON FINANCIAL SERVICES., UNSAFE AT ANY BUREAUCRACY: CFPB JUNK SCIENCE AND INDIRECT AUTO LENDING, p.51–52 (2015). https://financialservices.house.gov/uploadedfiles/11-24-15_cfpb_indirect_auto_staff_report.pdf

⁶ According to the Wall Street Journal, "Standard & Poor's Ratings Services . . . warned it would potentially lower the company's ratings if it failed to secure financial holding company status." An Ally official stated that "[n]o investor publicly was going to invest in us unless we got financial holding company status. And we could not do that without coming to terms with the CFPB." Andrew R. Johnson, *Ally Receives Fed Approval for Financial Holding Company Status*, THE WALL STREET JOURNAL, (Dec. 23, 2013). [Washington's Latest Bank Heist](http://www.wsj.com/articles/washingtons-latest-bank-heist-1429848800), THE WALL STREET JOURNAL, (Apr. 6, 2015).

Myth Four

Enactment of S.J.Res. 57 would preclude the CFPB from taking future regulatory action to address anti-discrimination actions in auto lending.

Facts

S.J. Res. 57 is consistent with ECOA since it does not ban pricing discretion (as noted repeatedly by DOJ) or pricing differentials between groups if they are based on a legitimate business rationale. The DOJ has accepted certain business reasons as legitimate to explain differentials in the amount of dealer participation earned in the financing of automobiles,⁷ yet the CFPB refuses to acknowledge these neutral factors or even to provide its rationale for rejecting them.

S.J.Res. 57 would not impact or amend or otherwise affect ECOA, or in any way prohibit, disrupt or affect enforcement of any fair credit laws by the CFPB, or any other agency or affect future agency efforts to enforce fair lending statutes or implementing regulations. Arguments regarding future actions must not distract from the importance of S.J. Res. 57 to ensure that agencies follow process safeguards and comply with congressional directives and oversight.

⁷ These neutral, business-related factors are necessary to gain a customer's business include:

- lender limits on the amount of dealer participation that may be earned;
- a customer's monthly payment/budget constraint;
- the "meeting or beating" of a competing offer from a bank, credit union, or another dealer;
- a promotional financing campaign extended to all buyers, or all buyers of a particular vehicle, on the same terms;
- an employee incentive program; and
- inventory reduction considerations that prompt the dealer to offer a discount to move certain vehicles off the lot (since the dealer accrues interest on those vehicles until they are sold).