Consumer Financial Protection Bureau

1700 G Street, N.W., Washington, DC 20552

February 20, 2014

The Honorable Alcee Hastings
U.S. House of Representatives
2353 Rayburn House Office Building
Washington, D.C. 20515

The Honorable Bill Posey
U.S. House of Representatives
120 Cannon House Office Building
Washington, D.C. 20515

Dear Representatives:

Thank you for your December 18 letter about indirect auto lending practices and compliance with anti-discrimination laws, such as the Equal Credit Opportunity Act (ECOA). The Consumer Financial Protection Bureau (Bureau) shares your commitment to ensuring that lending practices are fair and equitable and that credit markets function competitively and efficiently for all consumers and honest businesses. We appreciate the opportunity to work with you on these important goals.

The Bureau's March 21, 2013 Indirect Auto Bulletin was published to offer guidance to all indirect auto lenders within the Bureau's jurisdiction about compliance with fair lending responsibilities under ECOA.[1] The Auto Bulletin highlighted the fair lending risk inherent in some indirect auto lenders' markup and compensation policies based upon the discretion those policies permit.

Consistent with Bureau procedures, the Bulletin was reviewed prior to issuance to ensure compliance with all legally applicable requirements. The Administrative Procedure Act (APA) sets out the principles by which federal agencies engage in regulatory activity and in applicable cases allows for comments from affected parties and the general public concerning an agency's activity. The APA does not impose a notice and comment requirement for general statements of policy, non-binding informational guidelines, or interpretive memoranda. Accordingly, the Bureau was not statutorily required to solicit comments about the Auto Bulletin.

You requested a more detailed explanation of our methodology. Demographic information, such as race, sex, and ethnicity, is not collected by non-mortgage lenders. However, this information is vital to assessing fair lending compliance. Thus, federal regulatory and enforcement agencies have long used proxy methods in non-mortgage data analysis. Various proxy methodologies are publicly available and have been used for decades in a number of different civil rights contexts, including voting rights cases, Title VII cases, and

[1] *Indirect Auto Lending and Compliance with ECOA*, CFPB Bulletin 2013-02, Mar. 21, 2013 *available at* http://files.consumerfinance.gov/f/201303_cfpb_march_-Auto-Finance-Bulletin.pdf.

constitutional challenges, including jury selection and equal protection matters. In addition, federal banking regulators have made clear that proxy methods may be used in fair lending exams to estimate protected characteristics where direct evidence of the protected characteristic is unavailable.[2]

In general, the proxy methodology used depends on the characteristic being proxied. For example, to proxy for gender, the Bureau relies on a first-name database from the Social Security Administration that reports counts of individuals by gender and birth year for first names occurring at least five times for a particular gender in a birth year.[3] The proxy method assigns a probability that a particular applicant is female based on the distribution of the population across gender categories (male or female) for the applicant's first name.

There is a greater variety of methods to proxy for race and national origin. A common method for proxying the probability that an applicant is Hispanic or Asian is to use the surname database published by the Census Bureau.[4] Another method to proxy for race and national origin—typically referred to as "geocoding"—uses the demographics of the census geography (e.g., census tract or block group) in which an individual's residence is located, and assigns probabilities about the individual's race or national origin based on the demographics of that area. This method is frequently used to proxy the probability that an applicant is African American, and it can be used to proxy for other racial and ethnic groups as well.

Over the last decade, another method to proxy for race and national origin has been developed that integrates the surname and geographical approaches described above. This method was developed by health research economists,[5] and it combines the respective probabilities generated by the surname and geographical proxies. Published research has found that the integrated approach produces proxies that correlate highly with self-reported race and national origin data and is more accurate than using surname or geography alone.[6] The Bureau uses the integrated proxy as the primary method for proxying race and national origin in our non-mortgage analyses.

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[2] *See Interagency Fair Lending Examination Procedures*, at 12-13, *available at* http://www.ffiec.gov/PDF/fairlend.pdf (explaining that "[a] surrogate for a prohibited basis group may be used" in a comparative file review and providing examples of surname proxies for race/ethnicity and first name proxies for sex); *see also*, http://www.philadelphiafed.org/bank-resources/publications/consumer-compliance-outlook/2012/first-quarter/fair-lending-webinar.cfm .

[3] http://www.ssa.gov/oact/babynames/limits.html.

[4] http://www.census.gov/genealogy/www/data/2000surnames/index.html.

[5] Marc N. Elliott et al., *A New Method for Estimating Race/Ethnicity and Associated Disparities Where Administrative Records Lack Self-Reported Race/Ethnicity*, HEALTH SERVICES RESEARCH 43:5, Part I (Oct. 2008).

[6] Marc N. Elliott et al., *Using the Census Bureau's Surname List to Improve Estimates of Race/Ethnicity and Associated Disparities*, HEALTH SERVICES & OUTCOMES RESEARCH METHODOLOGY (2009) 9:69-83.

We are aware of proxy methods for race and national origin that use nonpublic information, such as proprietary databases developed in the private sector matching first or middle names to certain racial or ethnic groups. For the purpose of conducting our supervisory work, we have chosen to use proxy methods that rely solely on public data so that lenders can replicate our methods without the need to recreate or purchase proprietary databases as part of their own fair lending compliance management systems.

As we noted above, proxy methods vary based on the characteristic being proxied (race, national origin, or gender), and there are several reasonable methods of proxying for each of these characteristics. Some methods, for example, use solely surname or geocoding. The Federal Reserve Board, which publicly released some of its proxy methods in July, uses a surname Census database to determine if a borrower is Hispanic and geocoding to determine majority minority census tracts.[7] Other methods, like the Bureau's, integrate the same sources of data into a single proxy for race and national origin. We have chosen the integrated method because we consider it appropriate and helpful in evaluating the large and complex portfolios of the auto lenders supervised by the Bureau. Similarly, we expect lenders to choose a proxy method that will support a compliance management system commensurate with their size, organizational complexity, and risk profile.

The Bureau's and Department of Justice's (DOJ) recently announced enforcement action against Ally Financial Inc. and Ally Bank demonstrates the type of fair lending risk identified in the Bureau's Indirect Auto Bulletin.[8] The CFPB and DOJ determined that more than 235,000 minority borrowers paid higher interest rates for their auto loans between April 2011 and December 2013 because of Ally's discriminatory pricing system. In addition to requiring Ally to pay $80 million in damages and $18 million in penalties to resolve these issues, the Bureau's and DOJ's coordinated orders require Ally to establish a new compliance framework. Specifically, Ally will monitor dealer markup in order to prevent or redress future discrimination or Ally can decide to eliminate dealer markups altogether. Within this framework, Ally will be able to exercise its business judgment about how best to achieve compliance with fair lending law.

You reference flat fees in your letter. Flat fees are mentioned in the bulletin merely as one example of a non-discretionary compensation mechanism; the bulletin does not mandate flat fees or any other particular system of dealer compensation. It is our understanding that a number of indirect auto lenders currently compensate auto dealers using a variety of non-discretionary or flat fee programs, and lenders may choose to adopt a variety of means, including alternative compensation policies, to address fair lending risk. However, it is not possible to predict with certainty how market-wide adoption of a single non-discretionary compensation program or multiple such programs would affect the market, nor is it possible to anticipate all the potential actions lenders may take to eliminate discrimination from their

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[7] http://www.philadelphiafed.org/bank-resources/publications/consumer-compliance outlook/outlook-live/2013/080613.pdf

[8] CFPB Bulletin 2013-02, Indirect Auto Lending and Compliance with the Equal Credit Opportunity Act, http://files.consumerfinance.gov/f/201303_cfpb_march_-Auto-Finance-Bulletin.pdf

indirect auto lending programs. As a general matter, however, the Bureau believes that the legitimate business needs of creditors and fair lending are compatible, a judgment that Congress has enshrined in law by enacting ECOA and by charging the Bureau with its enforcement.

You also inquired about controls applied to the analysis of dealer participation. Each supervisory examination or enforcement investigation is based upon the particular facts presented by the entity under review. Thus, in our analyses we consider analytical controls which are appropriate to each particular entity. The controls are dependent upon the particular lender's policies, practices, and procedures. When lenders share with us the nature and results of their own analyses, we are open to hearing specific explanations for the decisions they have made to include particular analytical controls that reflect a legitimate business need. Because of this case-by-case determination we cannot identify each control that we apply in the analysis to ensure that borrowers are similarly situated. We would note, however, that creditworthiness factors like credit scores, debt to income ratios, characteristics of the collateral, and terms of the deal, like the amount financed, down payments, and any trade-in value, are already taken into account by lenders in arriving at the appropriate "buy rate." Because these factors are taken into account when determining the appropriate buy rate and are, therefore, considered in the overall interest rate the consumer receives, they are generally not appropriate to use as "controls" for an analysis of markup alone.

Thank you for bringing your concerns to the Bureau's attention and for the opportunity to respond. I look forward to working with you on this important issue as the Bureau continues to work to help markets operate more fairly and effectively for consumers and businesses.

Sincerely,

Richard Cordray

Richard Cordray
Director

Cc: The Honorable Ileana Ros-Lehtinen, Member of Congress
The Honorable Corrine Brown, Member of Congress
The Honorable John L. Mica, Member of Congress
The Honorable Jeff Miller, Member of Congress
The Honorable Mario Diaz-Balart, Member of Congress
The Honorable Debbie Wasserman Schultz, Member of Congress
The Honorable Theodore E. Deutch, Member of Congress
The Honorable Richard B. Nugent, Member of Congress
The Honorable Dennis A. Ross, Member of Congress
The Honorable Fredrica S. Wilson, Member of Congress
The Honorable Ron DeSantis, Member of Congress
The Honorable Lois Frankel, Member of Congress
The Honorable Joe Garcia, Member of Congress
The Honorable Patrick E. Murphy, Member of Congress