CARLTON FIELDS

CFPB and DOJ Enter Fourth Enforcement Order Against Indirect Auto Lender Based On Discriminatory Loan Pricing Policies

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On February 2, the Consumer Financial Protection Bureau (CFPB) and Department of Justice (DOJ) announced entry of a consent order against Toyota Motor Credit (TMC), the U.S. financing arm of Toyota Motors' subsidiary Toyota Financial Services, and the largest U.S. captive auto lender. The order requires TMC to change its dealer pricing and compensation policies to reduce dealer discretion in setting interest rates and pay restitution of up to $21.9 million to minority borrowers found by the agencies to have paid higher interest rates without regard to creditworthiness as a result of dealer markups permitted by TMC. Indirect auto lenders such as TMC set interest rates at which they are willing to purchase consumer finance contracts based on consumer credit scores and other credit risk criteria. These "buy rates" are conveyed to auto dealers by the lenders. It has been a longstanding industry practice for indirect lenders to permit dealers to mark up contract interest rates above the buy rate, allowing the dealers to receive a participation based on the interest revenue differential as additional compensation for

originating the loan. In a guidance bulletin issued in 2013 ("the Bulletin"), the CFPB advised indirect lenders that dealer markup policies which give dealers discretion to increase contract rates "create a risk of pricing disparities on prohibited bases such as race or national origin" and warned that it would pursue lenders for ECOA violations. The order against TMC ended a DOJ and CFPB investigation begun in 2013. It is the fourth joint DOJ-CFPB enforcement order against an indirect auto lender for loan pricing policies claimed by the CFPB to have resulted in discriminatory impact in violation of ECOA. Similar enforcement orders were previously entered against three other indirect lenders, including another major auto manufacturer's captive financing entity, and two large retail banks. The TMC Order brings the total remediation ordered to be paid for these violations to nearly $162 million. The investigation did not find that TMC intentionally discriminated against its customers, but rather that its discretionary pricing and compensation policies resulted in discriminatory outcomes with respect to loans for which Toyota Motors did not reduce the loan prices through subsidies. Specifically, the enforcement order states that during the relevant period, TMC permitted dealers to mark up contract rates on non-subsidized loans up to 250 basis points, and that this policy resulted in African-American and Asian and Pacific Islander borrowers paying higher interest rates than non-Hispanic white borrowers without regard to borrower creditworthiness. According to the CFPB, TMC's pricing and compensation structure over the period covered in the order resulted in payment by African-American borrowers of an average of over 27 basis points more for their auto loans, and payment by Asian and Pacific Islander borrowers of over 18 basis points more for their loans. The order also states that TMC did not monitor whether such prohibited discrimination occurred, although it notes that in 2014, TMC implemented a dealer monitoring program to enhance compliance. In addition to paying up to $21.9 million in redress, TMC is required to maintain compliance management systems designed to assure compliance with consumer financial laws, including ECOA, and implement one of three optional dealer compensation policies. These policies include: limiting dealer discretion in marking up contract rates to 125 basis points for contracts with durations of up to 60 months and to 100 basis points for longer contracts; establishing pre-set rates of dealer participation providing non-discretionary compensation to dealers not to exceed those same rates, but allowing dealers to include lower dealer rates based on lawful exceptions under fair lending; and not allowing dealers any discretion to set the contract rate unless neither the DOJ nor the CFPB Fair Lending Director object. The CFPB again used a geography and name based proxy analysis methodology to make the findings of disparate impact set forth in this order, as it did in its 2013 Bulletin and prior orders. The methodology combines geography-based and name-based probabilities based on U.S. census data "to form a joint probability using the Bayesian Surname Geocode method." As the pricing policies criticized by the CFPB directly impact auto dealers, who are exempt from the CFPA under Dodd Frank, they contend that the CFPB's pursuit of indirect lenders was an attempt at an end run around that exemption and legislation has been introduced on their behalf questioning the use of that proxy analysis, and the lawfulness of the 2013 Bulletin. According to the CFPB, auto loans are the third-largest source of outstanding household debt in the United States, after mortgages and student loans. The CFPB's Fair Lending Director works with the DOJ in investigating and enforcing violations of ECOA by CFPB

covered entities, including larger participants in the auto finance market and other financial institutions subject to CFPB supervision and enforcement.

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