

CFPB Takes Aim at Indirect Auto Lenders for Violations of Fair Lending Law

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May 2, 2013 -- The auto dealer industry fought hard for their exemption from the provisions of Dodd-Frank. But that exemption does not extend to banks and other lenders who finance consumer retail vehicle purchases by buying retail contracts from the dealers. And the CFPB has sent a clear message that it intends to hold indirect lenders who purchase retail contracts originated by auto dealers responsible for interest pricing practices if they result in a discriminatory impact in violation of the Equal Credit Opportunity Act ("ECOA"). ECOA prohibits discrimination by creditors in credit transactions based on race, sex, national origin, age and other factors. Discrimination prohibited by ECOA does not require a showing of intent to discriminate. Rather, it can be established if the creditor's policies result in disparate impact with respect to protected classes of individuals. Thus, a creditor may be found in violation if its actions have a discriminatory effect, demonstrated by statistical analysis, for example, even absent intentional discrimination. ECOA's definition of a "creditor" includes "assignees of original creditors who participate in the decision to extend, renew, or continue credit". According to the CFPB, indirect auto lenders evaluate credit applicants, and set and communicate the interest rates at which they will purchase the contracts ("buy rates") to dealers. The lenders may also allow the dealers to mark up the buy rates in setting the rates charged to the customers. The CFPB takes the position that such actions constitute participation in a credit decision under the ECOA, and that therefore, an indirect auto lender who provides the dealer with buy rates and permits the dealer to mark up those rates, becomes a creditor under the ECOA when the indirect auto lender purchases the dealer contract. In February, the CFPB sent letters to four banks informing them that it believed the banks may have violated the fair lending provisions of the ECOA in allowing dealers to mark up the interest rates on vehicle finance contracts purchased by the banks. The letters warned the lenders they might be sued for violating the act, and gave those banks 15 days to explain the markups. CFPB Director Richard Cordray also announced in February that the Bureau had received numerous complaints about auto lenders on its consumer complaint database, which apparently was related to the CFPB sending the letters. In a February 5th conference call,

Cordray also stated that auto lending is within the CFPB's jurisdiction, and that the Bureau was examining institutional auto lending. Then, on March 21st, the CFPB issued a pointed guidance bulletin addressing indirect auto lending and compliance with ECOA, also stating that indirect lenders may be liable for violations of ECOA by auto dealers if the lender participates in the credit decision, and the lender's pricing policies result in discrimination. While the guidance bulletin is not actually law, it makes clear the CFPB's expectations that indirect lenders who participate in credit decisions comply with ECOA's fair lending requirements, and that lenders who participate in loan pricing decisions or setting buy rates which have a discriminatory impact will be found in violation of the law. The bulletin further states that indirect auto lenders should take steps to ensure that they are operating in compliance with ECOA as it applies to dealer markup and compensation policies by taking a number of steps, including, but not limited to:

- 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, so as to address unexplained pricing disparities on prohibited bases; or
- eliminating dealer discretion to mark up buy rates and instead compensating dealers using another mechanism, such as a flat fee per transaction, that does not result in discrimination;
- developing a robust fair lending compliance policy and management program that includes training, monitoring for compliance, and review of lending policies for potential fair lending violations, including disparate impact;
- communicating the requirements of ECOA to dealers, the lender's expectations with respect to ECOA compliance, and the dealer's obligation to mark up interest rates in a non-discriminatory manner (where such markups are permitted);
- conducting regular analyses of dealer-specific and portfolio-wide loan pricing data for potential disparities on a prohibited basis resulting from dealer markup and compensation policies;
- taking prompt corrective action against dealers, including restricting or eliminating their use of dealer markup and compensation policies or excluding dealers from future transactions, when analysis identifies unexplained disparities on a prohibited basis; and
- promptly remunerating affected consumers when unexplained disparities on a prohibited basis are identified either within an individual dealer's transactions or across the indirect lender's portfolio.

The costs for setting up the compliance policies and monitoring outside dealers to ensure that loan markup policies don't violate fair lending requirements as recommended by the CFPB may be prohibitive, in particular for smaller indirect lenders. Indeed, it would appear that given the cost of such intensive and detailed monitoring, the CFPB's intention may be to take away any pricing discretion from lenders. The bulletin concludes with the CFPB's statement that it will continue to closely review indirect auto lenders, utilizing all regulatory tools to assess whether enforcement or

other actions may be necessary to "ensure that the market for auto lending provides fair, equitable, and nondiscriminatory access to credit for consumers." The Full Bulletin can be found here: http://files.consumerfinance.gov/f/201303_cfpb_march_-Auto-Finance-Bulletin.pdf

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