House Passes Bill Challenging CFPB Indirect Regulation of Auto Dealers

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On November 18, the House passed HR 1737, entitled the "Reforming CFPB Indirect Auto Financing Guidance Act," with wide bi-partisan support. The proposed legislation challenges the legality of the Consumer Financial Protection Bureau ("the CFPB" or "Bureau")'s March 2013 guidance bulletin ("Bulletin") on ECOA fair lending requirements for indirect auto lenders who "permit dealers to increase consumer interest rates and compensate dealers with a share of the increased interest revenues." The Bulletin targeted the common industry practice of allowing auto dealers to mark up contract interest rates above the indirect lender's buy rate and receive a participation based on the interest revenue differential as additional compensation for originating the loan. According to the Bulletin, the incentives and discretion afforded to dealers to increase rates paid by consumers creates a risk of pricing disparities on prohibited bases such as race or national origin. Since indirect lenders who purchase consumer auto loans are creditors under the Equal Credit Opportunity Act, the Bulletin warned of the Bureau's intention to hold indirect lenders liable for discrimination resulting from markup and compensation policies. It also outlined rigorous fair lending policy expectations for indirect lenders, including the imposition of significant control by lenders on dealer compensation and markup policies. Indeed, several months later, the Bureau issued its largest enforcement order as of that date, assessing nearly $100,000,000 against Ally Bank, an indirect auto lender bank, for alleged violations of ECOA which the CFPB claimed occurred as a result of such policies.[1] Attempts to implement certain procedures and policies expected by the Bureau under the Bulletin, such as intense monitoring and analysis of dealer loan pricing data and controlling dealer pricing, has created enormous business costs for indirect finance lenders, which may be reflected in fewer financing options for consumers. The Dodd Frank Consumer Financial Protection Act (CFPA) specifically excludes auto dealers from its purview. HR 1737's sponsors claim that the Bulletin represents the Bureau's attempt at an end run around Dodd Frank's exclusion of auto dealers by attempting to regulate compensation paid to auto dealers. Specifically, by using enforcement actions against large indirect auto lenders to pressure finance companies to lower caps they set on dealer reserve or eliminate this discretion altogether. The bill's sponsors also question the validity of the proxy analysis methodology for assessing disparate impact used by the Bureau and Department of Justice to find disparate impact in the Ally Bank case[1], and to support its statement in the Bulletin that markup policies create a risk of illegal pricing disparities. They claim the methodology resulted in an overstatement of disparate impact, and that the CFPB should be required to make public all data it relied upon to support its validity. The proposed law declares the Bulletin to be without force and effect, and would amend the CFPA to direct the CFPB, when proposing and issuing guidance primarily related to indirect auto financing, to:

- provide for a public notice and comment period before issuing the guidance in final form;
- make publicly available all information relied on by the CFPB;
- redact any information exempt from disclosure under the Freedom of Information Act;
- consult with the Board of Governors of the Federal Reserve System, the Federal Trade Commission, and the Department of Justice; and
- study the costs and impacts of the guidance to consumers and women-owned, minority-owned, and small businesses.

The Bill is widely favored by the auto industry, although it could face an uphill climb in the Senate. Yet, there is much to be said for making sure the CFPB does not exceed the authority granted to it by the CFPA, and for transparency in the methodologies it uses to set policy, and assess disparate impact in regulatory and enforcement actions. *Read the proposed legislation: HR 1737 - Reforming CFPB Indirect Auto Financing Guidance Act* ___ 1 The proxy methodology used combined geography-based and name-based probabilities, based on public census data, to form a joint probability using a surname geocoding (BISG) method. The joint race and national origin probabilities obtained through the BISG method were then used directly in the CFPB's and DOJ's models to estimate disparities in dealer markup based on race or national origin.

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