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The Regulatory Landscape for Indirect Auto Lenders After Ally

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In December 2013, the Consumer Financial Protection Bureau (CFPB) announced its first settlement in the indirect auto lending industry. The target company was Ally Financial Inc. and Ally Bank (Ally). The CFPB alleged that Ally had engaged in discriminatory pricing by charging minority consumers higher dealer markups for their auto loans. Ally was ordered to pay $80 million in damages to 235,000 minority borrowers and $18 million in penalties.

Last week, the Republican Staff of the U.S. House of Representatives Committee on Financial Services released its second report in two months criticizing the CFPB's handling of the *Ally* matter. The two congressional reports punctuate the increasing tension regarding whether and the extent to which "dealer discretion" to increase interest rates gives rise to liability for auto finance companies under fair lending law. The following discusses the genesis of this tension and the regulatory landscape after *Ally*.

CFPB 2013 Auto Finance Bulletin

In March 2013, the CFPB issued a bulletin on indirect auto lenders' compliance with the Equal Credit Opportunity Act (ECOA) and its implementing regulation, Regulation B. In pertinent part, the bulletin states that an indirect auto lender's markup and compensation policies may "alone be sufficient to trigger liability" under ECOA under a disparate impact, or "effects test," theory of liability. It then outlines steps indirect auto lenders may take to reduce their fair lending risk, such as imposing controls on dealer markup and compensation policies. In the alternative, the CFPB suggests that lenders eliminate dealer discretion to mark up buy rates altogether, and instead move to a flat fee per transaction.

The bulletin has proven controversial. Members of the House introduced a bill in April 2015 seeking to nullify the March 2013 bulletin. The bill, entitled the *Reforming CFPB Indirect Auto Financing Guidance Act* (HR 1737 (F. Guinta, R-NH)), passed the House on November 18, 2015, by a vote of 332-96. Immediately following the bill's passage in the House, the Republican Staff of the Committee of Financial Services of the U.S. House of Representatives published two related congressional reports. The reports pose certain threshold legal questions: for example, whether disparate impact claims are cognizable under ECOA jurisprudence. The reports then suggest that even if such claims were cognizable, it would be difficult to make a *prima facie* disparate impact auto lending claim due to the challenges with accurately predicting the race and ethnicity of borrowers. The reports were critical of the CFPB's reliance in *Ally* on a proxy method that uses a consumer's last name and address to generate probabilities that the consumer belonged to one or more racial or ethnic groups. According to a November 2014 study commissioned by the American Financial Services Association, this proxy method is subject to "significant bias and estimation error." The congressional reports suggest that, given the complexities surrounding indirect auto financing, only a direct apples-to-

apples comparison – by comparing consumers with similar creditworthiness financing a similar amount at the same dealer at around the same time - would enable one to draw a meaningful conclusion about whether a person was “overcharged” for purposes of ECOA liability.

Regulatory Landscape After Ally

Notwithstanding the challenges presented above, the CFPB will continue its aggressive enforcement against indirect auto lenders. In June 2015, the CFPB extended its supervisory authority over “larger participants” of nonbank auto finance companies. The “larger participants” are approximately 34 entities that make, acquire, or refinance 10,000 or more loans or leases in a year. This expansion of authority enables the Bureau to oversee all activity by these companies to ensure compliance with federal consumer financial laws, including ECOA, the Truth in Lending Act, the Consumer Leasing Act, and Dodd-Frank’s prohibition on unfair, deceptive, or abusive acts or practices. Given the heightened and expanded regulatory scrutiny, auto lenders should consider reducing their risk profile by implementing a robust compliance management system (CMS). In particular, a fair lending compliance program to monitor for fair lending risk may be advisable. The adoption by lenders of a strong CMS with written policies and procedures, including a clear and conspicuous fair lending policy statement, would demonstrate the lenders’ commitment to fair lending practices, and may reduce their risk of exposure.