

Commercial Financial Services Brief: CFPB Bulletin Provides Warning to Indirect Lenders and Auto Dealers

March 25, 2013

On March 21st the Consumer Financial Protection Bureau (CFPB) issued CFPB Bulletin 2013-02 as a reminder to lenders engaged in indirect lending about their responsibilities under the Equal Credit Opportunity Act (ECOA) and Regulation B. The CFPB focused on the role of the indirect lenders in the sale of motor vehicles, particularly their responsibilities as "creditors" under ECOA.

Background

Indirect auto financing typically involves a motor vehicle dealer collecting a credit application from an applicant and forwarding the application to one or more prospective indirect auto lenders. After evaluating the applicant, indirect auto lenders may decline to become involved in the transaction or they may choose to provide the dealer with a risk-based "buy rate" that establishes the interest rate at which the lender is willing to purchase the retail installment sales contract that the consumer has executed with the dealer for the purchase of the vehicle. The dealer may contract for interest at a rate higher than the buy rate and the difference (many times called the dealer's "participation") is paid to the dealer by the indirect lender.

Dealer Participation and Regulation B

The CFPB expressed concern that policies of indirect lenders permitting dealers to "mark-up" the buy rate on a discretionary basis can result in pricing disparities on the basis of race, national origin, and potentially other prohibited bases. ECOA prohibits a "creditor" from discriminating in credit transactions on the basis of race, color, religion, national origin, sex, marital status, age, and other protected categories. The term "creditor" includes any assignee of an original creditor who participates in the decision to extend, renew, or continue credit. As a result, although there are a variety of models used by indirect lenders and dealers, the CFPB believes that the standard practices of indirect auto lenders likely constitute participation in a credit decision under the ECOA and Regulation B.

The CFPB went on to point out that when credit pricing disparities based on a prohibited basis exist within an indirect auto lender's portfolio, indirect lenders may be liable under the legal doctrines of both disparate treatment and disparate impact. Disparate treatment can be found when there is actual differential treatment of an applicant based on race, color, religion or other prohibited basis. Disparate impact is the legal doctrine that policies may be considered discriminatory if they have a disproportionate "adverse impact" on members

of a protected group, even if there is no actual intent to discriminate.

The CFPB specifically noted that "[a]n indirect auto lender's markup and compensation policies may alone be sufficient to trigger liability under the ECOA if the lender regularly participates in a credit decision and its policies result in discrimination. The disparities triggering liability could arise either within a particular dealer's transactions or across different dealers within the lender's portfolio."

The End of Dealer Participation As We Know It?

The CFPB gave warning to those lenders subject to its supervision that they must take steps to ensure that they are operating in compliance with the ECOA as applied to dealer markup and compensation policies. Suggested steps to manage their ECOA obligations include:

- Imposing controls on dealer markup and compensation policies, and monitoring and addressing the effects of those policies so as to address pricing disparities on prohibited bases; or
- Eliminating dealer discretion to mark up buy rates and fairly compensating dealers using other methods, such as a flat fee per transaction, that does not result in discrimination.

The CFPB suggested that if lenders are going to continue to permit discretionary dealer pricing, the indirect lenders should consider steps that include:

- Sending communications to all participating dealers explaining the ECOA and stating the dealer's obligation to mark up interest rates in a non-discriminatory manner;
- Conducting regular analyses of both dealer-specific and portfolio-wide loan pricing data;
- 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 prohibited disparities; and
- Promptly reimbursing affected consumers when prohibited disparities are identified.

Finally, the CFPB made clear that it will be closely reviewing the lenders subject to its supervision to determine compliance with these requirements. It appears that the CFPB will be focusing significant attention on the auto finance arena. This bulletin puts a clear stake in the ground regarding regulatory expectations for lenders engaged in indirect auto financing and provides a nudge in the direction of significantly restricting or even eliminating dealer participation as a standard industry practice.

For further assistance regarding your auto finance activities, please contact George Mainz at 320.252.4414.

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