



Discretionary Pricing in Auto Lending and the CFPB (Oh No!)

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Recently, the Consumer Financial Protection Bureau (the CFPB) issued [Bulletin 2013-02](#) titled “Indirect Auto Lending and Compliance with the Equal Credit Opportunity Act (ECOA).” In summary, this Bulletin confirms what has been previously reported about four banks engaged in indirect auto lending [being warned about the CFPB’s concern over discretionary pricing in auto financing](#). The CFPB asserts that when a lender’s policies do not restrict an auto dealer’s ability to negotiate the interest rate at which an automobile purchase is financed, “there is a significant risk [of] pricing disparities on the basis of race, national origin, and potentially other prohibited basis.”

Issues

A threshold issue in this Bulletin is the CFPB’s continued insistence that a legal theory, “disparate impact,” is law under the ECOA. Last year (see the [CFPB’s Bulletin 2012-04](#)), the agency indicated it would apply “disparate impact” to consumer financial products. The theory states that lenders can be sanctioned for actions that have a discriminatory effect — as demonstrated by statistical analysis, for example — even if they did not intend to discriminate. The validity of that legal theory is hotly contested as many do not believe the ECOA statute says something it does not say, which is what must be true if the “disparate impact” theory is valid.

Next, the CFPB asserts that their research indicates auto dealers having discretion to negotiate the rate offered to their customers may lead to minorities being charged more for auto financing than similarly situated white customers. Unlike fair lending analyses in the mortgage lending arena, where information on a borrower’s race and ethnicity is required to be collected, that information is not collected for auto financing transactions. The research conducted by the CFPB was necessarily based on proxies for the race and ethnicity of the borrowers. For instance, one such proxy may be the predominant racial makeup of a particular Metropolitan Statistical Area (MSA). The obvious problem presented by the use of this measure as proxy for race and/or ethnicity is that regardless of the percentage of the population of an MSA that is African American, there is a significant margin for error that any particular transaction reviewed did not involve an African American borrower. In short, even assuming a valid theory of “disparate impact” exists under the ECOA, there is no reliable way to measure whether allowing auto dealers discretion in pricing financing transactions has such an impact.

Auto Dealers and Unintended Consequences

The Dodd-Frank Act excluded auto dealers from regulatory oversight by the CFPB and left auto dealers to be regulated by the Federal Trade Commission (FTC). That said, auto dealers are the party to the auto financing transaction most impacted by the CFPB’s guidance on indirect auto lending. Because of this awkward reach by the CFPB, the likelihood of unintended consequences, such as the possibility of increasing the overall cost to consumers of purchasing and financing a vehicle should not be overlooked. As the CFPB currently has outsized influence on the regulation of all things consumer finance related, its position on discretion in pricing in auto finance transactions will likely be formally or informally adopted by those who regulate industry participants not under the CFPB’s regulatory umbrella.



As lenders move at varying speeds, or not at all, toward eliminating discretionary pricing, auto dealers will - as a result of operational realities - congregate to lenders who leave their policy unchanged and competition for auto dealer paper will suffer. In theory, lenders who have eliminated auto dealer interest rate pricing discretion will have to raise their auto dealer compensation across the board if they wish to remain competitive. If things unfold in this way, the unintended consequence of the CFPB's policy on indirect auto lending will be to effect an overall increase in the cost of financing a vehicle through an auto dealer.

A Better Way to Do It

Because the CFPB's indirect auto lending policy will have such an impact on the marketplace, the better approach to this issue would be to go through the formal rulemaking process, obtain expert input from interested parties and if necessary, issue a clear rule with a reasonable implementation schedule. Regulation of the indirect auto lending space by enforcement will, at a minimum, create uncertainty in the marketplace, likely result in irrational pricing differences in the costs of financing a vehicle and could result in all financing customers paying more to buy a vehicle.

What to Do Now

Assuming the CFPB does not rethink its approach to this issue, lenders and auto dealers alike are faced with the unfortunate reality of having to evaluate their current auto financing practices against a standard that may not be good law ("disparate impact") and cannot be assessed with reasonable certainty (proxies used for race and ethnicity).

Even with this uncertainty and regardless of whether an existing policy on pricing discretion is retained or eliminated, there are steps that should be taken to ensure that all consumers are treated fairly:

- **Adopt & Maintain a Fair Lending Policy and Enforce It:** Under the ECOA it is absolutely against the law to treat consumers differently in any aspect of a credit transaction based on their race, color, religion, national origin, sex, marital status, age, receipt of income any public assistance program, or the exercise in good faith of a right under the Consumer Credit Protection Act.
- **Let Your Customers Know:** Display the policy and provide your customers with a name and contact information of a senior manager to report any instance of unlawful discrimination.
- **Training:** All employees who participate in the credit transaction should receive periodic training on your organization's fair lending policy and the prohibitions contained in the ECOA.
- **Review Your Pricing Policies:** In light of the CFPB's guidance, it is advisable for indirect auto lenders to explore and model alternatives to allowing auto dealers pricing discretion that will at the same time keep their product competitive.

Needless to say, lenders in the indirect auto lending space and auto dealers will do well to closely monitor developments surrounding Bulletin 2013-02 as they evolve.

The attorneys in Locke Lord's **Consumer Finance Practice** group have experience in complying with regulation of the CFPB and the FTC as well as state consumer finance regulators. We are available to help our clients who are auto lenders and auto dealers comply with the issues raised in this article and with legal compliance with new and pre-owned auto financing.

For more information on the matters discussed in this *Locke Lord QuickStudy*, please contact the authors:

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