CFPB Developments for Indirect Auto Loan Lenders

The Current Landscape

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IMPORTANT CFPB DEVELOPMENTS FOR INDIRECT AUTO LOAN LENDERS

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Indirect auto lenders are not immune from CFPB regulatory authority. In recent years, the CFPB has continued to focus its attention on "unfair and deceptive" aspects of auto lending. Lenders can expect to see continued scrutiny of auto lending practices and policies. Credit unions must be aware of CFPB actions and ensure their policies are drafted in a way that reduce CU risk in this market.

I. Background.

A. Consumer financing for automobile purchases. These regulations apply to:

1. Financial institutions; or
2. Auto dealers. An auto dealer can be:
   a. Direct (consumer goes straight to lender himself/herself); or
   b. Indirect (consumer goes to auto dealer and auto dealer sells contract to third party lender).

B. Indirect Auto Financing.

1. Dealer collects purchaser's information.

2. Information is submitted to indirect auto lenders for evaluation.

3. Indirect auto lenders offer "buy rate" if interested in financing the transaction. The "buy rate" is subject to adjustment, exceptions, and/or modification as a result of negotiations between dealer and indirect auto lender.

4. Optional “Mark Up” Policy:

    a. Some indirect auto lenders allow the dealers to mark up the interest rate in exchange for a "reserve" or "participation."

    b. Reserve/participation = compensation from indirect auto lender to dealer based on difference between mark up rate and buy rate.

II. The Current Landscape.

A. CFPB Regulatory Authority.

1. **Auto dealers** are (currently) **exempt** from CFPB regulatory oversight. [Section 1029 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, 12 U.S.C. § 5519 (2010).]

2. **Indirect auto lenders** are **NOT exempt** from CFPB regulatory oversight.

B. Equal Credit Opportunity Act (“ECOA”). [15 U.S.C. § 1691 *et seq*.]

1. ECOA says it is illegal for "creditors" to discriminate against credit applicants on the basis of race, color, religion, national origin, sex or marital status, age, economic status or the good faith exercise of rights under the Consumer Credit Protection Act. [15 U.S.C. § 1691.]

2. You **__may__ ask about and consider the permanent residency** and **immigration status** of consumers. [12 C.F.R. §§ 1002.5-1002.6 (2011).]

    a. This is relevant to the determination of your rights and remedies for repayment (*i.e.* whether the consumer has the right to stay in the country long enough to repay the debt).

    b. Immigration statuses:

        i. __Nonimmigrant__ = foreign national in the U.S. temporarily; permission granted for study, employment, tourism, etc.

        ii. __Documented immigrant__ = legal permanent resident; green card holder.

        iii. __Undocumented immigrant__ (a/k/a illegal alien) = no legal residency; subject to deportation.

C. "Creditor" = any person who:

1. Regularly extends, renews, or continues credit;

2. Arranges for extension, renewal, or continuation of credit;

   or

3. Is an assignee of an original creditor and participates in the decision to extend, renew, or continue credit. [15 U.S.C. § 1691a(e).]

D. Regulation B adds to the definition of "creditor":

1. Anyone who, in his or her day-to-day business operations, participates in the decision to extend credit or not. [12 C.F.R. § 1002.2(*l*).]

2. Commentary classifies "creditor" even more broadly—if you participate in the credit decision at all, you are a creditor. [12 C.F.R. pt. 1002, Supp. I, § 1002.2, ¶ 2(*l*)-1.]

E. Indirect auto lenders are almost always creditors under the ECOA & Regulation B.

1. Examples:

a. You are an indirect auto lender that evaluates an applicant's information, establishes a buy rate, and communicates that buy rate to the dealer for the purpose of buying the obligation at that rate if the purchase goes through. ☐ CREDITOR

b. You are a lender that gives auto dealers rate sheets establishing buy rates. You allow dealers to mark up those buy rates. You purchase contracts from those dealers using your rate sheets. ☐ CREDITOR

2. Non-participating Assignee Exception [15 U.S.C. §

1691a(e).]:

a. You are an indirect auto lender that obtains loans AFTER origination; <u>and</u>

b. You do not participate in the decision to extend credit to borrowers in any way (*i.e.* no pipeline schemes with dealers).

III. What is the CFPB doing?

A. As of 2012, the CFPB is cracking down on the auto

finance/lending industry.

B. The CFPB is identifying and holding lenders liable for policies that result in discrimination. If the lender's policy allows discrimination, the CFPB blames the lender.

IV. What does the CFPB want to accomplish?

A. Regulate finance charges associated with car loans through auto dealers.

B. Prevent discrimination based on race, national origin, economic status, etc.

C. Promote a level playing field throughout the auto lending market.

D. **Create a mechanism for dodging Section 1029 (exclusion for auto dealers)!**

V. How is the CFPB accomplishing this?

A. Threatening ECOA suits against violators.

B. Using authority over financial institutions to regulate auto dealers.

C. Holding lenders liable for dealers' noncompliance with the ECOA and fair lending laws.

D. Issuing strong recommendations for indirect auto lenders (a/k/a throwing them a bone).

VI. What should you do?

A. Follow the CFPB's advice.

B. Take the bone—be absolutely sure you are operating in compliance with fair lending laws.

C. Consider taking one or more of the following steps:

1. Continually monitor and address the implications of your policies to maintain compliance with fair lending laws.

2. **Eliminate dealer mark up discretion** and create a new compensation mechanism that does not involve or carry the risk of discrimination.

    a. Example: Offer flat fees to dealers for choosing you.

    b. Even better example: Stair step model – have the flat fee increase as the dealer originates more and/or larger contracts for the lender.

3. Create a management team to oversee and ensure fair lending compliance.

D. You're thinking: "I don't want to eliminate my dealer mark up and compensation policies."

1. Okay, be brave…but smart.

    a. Send all of your auto dealers information explaining the ECOA.

    b. Make it clear that you operate and will continue to operate in compliance with fair lending laws. Example: public nondiscrimination notice.

    c. Make it clear the dealer himself/herself MUST operate in compliance with the ECOA.

    d. Regularly analyze your own lending data and data from your dealers.

    e. Identify and address irregularities:

        i. Take prompt corrective action against dealers in violation.

ii. Examples: take away mark up privileges; discontinue relationship; ban dealer from future transactions; etc.

iii. Create remediation process for consumers subjected to discrimination or unfair lending practices.