

**CFPB Going After Dealer Markups**  
**By ADR Staff**  
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The Consumer Financial Protection Bureau (CFPB) is recommending indirect auto lenders impose controls on dealer markups or eliminate them altogether in order to ensure compliance with the Equal Credit Opportunity Act (ECOA). Consequently, auto dealers engaging in third-party or indirect lending transactions may soon be required by their lending agencies to convert to a flat fee compensation arrangement rather than the traditional APR markup.

In a March 21, 2013, press release, CFPB Director Richard Cordray asserted the CFPB's authority to pursue auto lenders whose policies, in the Bureau's opinion, harm consumers through unlawful discrimination. The Dodd-Frank Act granted the CFPB authority to supervise various lending agencies, including indirect auto lenders, but specifically set non-BHPH auto dealers outside the reach of the CFPB's supervisory powers. The CFPB's recently published guidelines, however, effectively negate that limitation by holding the indirect auto lending agencies accountable for auto dealers' activities with respect to fair lending policies. Fred Becker, president and CEO of the National Association of Federal Credit Unions, explains it thus, "This essentially treats the auto dealer as a third-party service provider of the credit union, increasing the credit union's risk for liability and giving the CFPB a way to reach auto dealers in the absence of direct statutory authority."

### **Recommended Controls on Dealers**

The CFPB recommends indirect auto lenders take steps to ensure they are in compliance with ECOA and Regulation B with respect to dealer markup and compensation policies. Those steps may include, but are not limited to:

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

### **Reasoning Behind the Decision**

In the bulletin, also issued March 21, 2013, the CFPB provides guidance for compliance with the ECOA and its implementing regulation, Regulation B, for supervised indirect auto lenders that permit dealers to increase consumer interest rates and that compensate dealers with a share of the increased interest revenues. This type arrangement is typically referred to as "dealer reserve" or "dealer participation". The CFPB believes that lender policies allowing dealer

reserve transactions increase the risk of pricing disparities among consumers based on prohibited bases, such as race or national origin. Although supporting documentation is not offered, the CFPB claims research indicates that markup practices may lead to African Americans and Hispanics being charged higher markups than other, similarly situated, white consumers.

The CFPB's interpretation of the ECOA and Regulation B discounts the Act's provision that limits a creditor's liability for another's actions in certain circumstances, thereby making the indirect lender liable for the auto dealer's actions. The CFPB asserts that the indirect lender's markup and compensation policies may be sufficient to trigger ECOA liability if the auto dealer's implementation of those policies results in prohibited discrimination. Additionally, they speculate that a lender may have known or had reasonable notice of a dealer's discriminatory conduct, "depending on the facts and circumstances."

### **Industry Reaction**

In a joint statement also issued on March 21, 2013, the National Automobile Dealers Association (NADA) and the National Association of Minority Automobile Dealers (NAMAD) note that both organizations strongly oppose any form of discrimination in auto lending, and agree with the CFPB that unlawful discrimination has no place in the marketplace. However, the Associations raise the following objections to the CFPB's approach to the subject of fair lending compliance with respect to indirect lending:

- The CFPB has not documented the statistical analysis giving rise to the allegations of discrimination. The lack of insight regarding demographic group selection, controls of various factors impacting finance rates, and a concise basis for finding of disparate treatment reduces confidence in the Bureau's analysis.
- The CFPB has not presented evidence that cost to the consumer has been considered. Consumers choose optional dealer-assisted financing because it is convenient and competitive. Removing the dealer's ability to discount the APR that it offers to consumers is anti-competitive and will weaken the consumer's opportunity to obtain financing at the lowest possible cost.
- The CFPB's actions are being conducted in a less than transparent manner. By implementing their decision through supervisory guidelines and enforcement actions, they circumvent procedural requirements to allow public comment and avoid engaging in data-driven analysis of market impact. Further, they bypass the Federal Reserve and the Federal Trade Commission, the two agencies vested with authority over auto dealers.

### **So Now What?**

The authority of the CFPB allows them to proceed at will with respect to supervision of the indirect lenders – and dealer markup arrangements. However, the statutorily created structure of the Bureau and the appointment of its current director, Richard Cordray, are under review in Congress. Recent judicial rulings have brought the constitutionality of Mr. Cordray's

appointment by the President into question. Republicans in the Senate are attempting to leverage Mr. Cordray's confirmation into an opportunity to bring the Bureau's funding process under Congressional oversight and establish governance by a committee rather than an individual director. If successful, the Bureau's free-ranging authority over all financial issues could eventually be curtailed.

In the meantime, national dealer and financial institution organizations will be active in Washington, attempting to engage the Bureau with respect to the issue, and working to build support for both industries' positions within Congress.

It has been widely reported that at least four banks received letters from the CFPB in February warning them of pending charges related to vehicle loans and interest-rate markups by dealers that appear discriminatory. And, Ally Financial recently confirmed in SEC documents that they are under investigation by the CFPB for similar actions. Dealers are strongly encouraged to abstain from any hint of discriminatory practices, educate yourself and your employees on the nuances of fair lending compliance, have written policies in place to ensure compliance, and then abide by them.

*[Update 12/20/2013]* Both Ally Financial and the Consumer Financial Protection Bureau (CFPB) have issued notice of Ally's execution of Consent Orders pertaining to allegations of disparate impact discrimination in the auto finance business. Ally's statement says that the company does not engage in or condone violations of law or discriminatory practices, and based on the company's analysis of its business, it does not believe that there is measurable discrimination by auto dealers. Regardless, Ally takes the assertions by the CFPB and DOJ very seriously and has agreed to the terms in the orders, which include enhancing dealer monitoring, reducing the perceived disparity for the protected classes outlined in the order, paying a civil money penalty of \$18 million and contributing \$80 million toward a settlement fund to be managed by an independent settlement administrator.

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