June 10, 2015

Dear Representative,

On behalf of Americans for Financial Reform and its undersigned member groups, we urge you to oppose H.R. 1737, the "Reforming CFPB Indirect Auto Financing Guidance Act." This legislation places unnecessary restrictions on the Consumer Financial Protection Bureau's (CFPB) oversight of auto financing practices — restrictions that do not exist for any other financial practice. These restrictions are designed to chill the agency's attempts to bring fairness and transparency to the auto lending market.

H.R. 1737 requires that 1) the CFPB rescind its guidance from March of 2013 regarding the fair lending risks associated with car dealer interest rate markups, and 2) the CFPB provide notice and take comments only for guidance related to fair lending risks.

The CFPB issued guidance in March 2013 regarding the liability of financial institutions under the Equal Credit Opportunity Act (ECOA) for auto loans those entities acquire from car dealers. Under the ECOA's definition of creditor, an assignee who buys auto loan contracts from dealers is liable for any discriminatory impact stemming from the ability to change interest rates offered to consumers upon the purchase of a vehicle. In the guidance, the CFPB stated that dealer interest rate markup creates significant fair lending risk for financial institutions. To eliminate that risk, the CFPB suggested that financial institutions consider compensating dealers through other means that do not have the same fair lending risk associated with them. Otherwise, these entities would have to continuously monitor their loan portfolios to comply with fair lending requirements and risk potential regulatory action on this front.

Dealer interest rate markup, also known as "dealer reserve" or "dealer participation," is a practice in which dealers receive compensation from a financial institution by increasing the interest rate beyond the rate at which the entity would buy the contract. The financial institution provides the dealer with a rate the lender would accept based on the borrower's risk profile, which is called a "buy rate." However, the financial institution then allows the dealer to add as much as 2 - 2.5% in additional interest to the loan, and the dealer keeps some or all of the difference as compensation. To give a sense of scale, the Center for Responsible Lending estimates that consumers who took out car loans in 2009 will pay $25.8 billion in additional interest over the lives of their loans due to these markups.

This practice has a long history of leading to racial discrimination. This is one of the last areas in consumer lending where an individual sitting across the desk from a consumer makes a decision about how much to charge that particular consumer for financing above and beyond the financing costs dictated by their credit worthiness. Intentionally or not, this often leads to minorities paying more than their fair share. In the mid-1990s, a series of lawsuits were filed against the largest auto finance companies in the country alleging that borrowers of color were more likely to have their loans marked up, and paid larger markups. The data used in those lawsuits indicated that borrowers of color were twice as likely to have their loans marked up, and paid markups twice as large as similarly situated white borrowers with similar credit ratings.

More recently, the CFPB and the Department of Justice entered into a consent order with Ally Financial Inc. and Ally Bank in December 2013, ordering them to pay $98 million in damages to minority borrowers who the Bureau found were being charged higher interest rates for their auto loans than similarly situated non-Hispanic white borrowers. The investigation that led to the order

found that borrowers who identified as African American, Latino, and Asian/Pacific Islander, paid between 20 and 30 basis points more for their loans than similarly-situated white borrowers, adding between $200 and $300 of additional interest over the life of those consumers' loans. The CFPB announced in September 2014 that it had reached additional settlements that required financial institutions to pay $54 million in damages to other borrowers.

Just last month, the Department of Justice filed a complaint against Evergreen Bank for charging African-American and Hispanic borrowers higher interest rates for motorcycle loans than non-Hispanic white borrowers. An investigation by the FDIC uncovered that Evergreen, through its Freedom Road Financial motorcycle loan program, charged African American and Hispanic borrowers interest rates 29 to 40 basis points higher than non-Hispanic white borrowers, resulting in $200 to $250 in additional interest over the life of those consumers' loans. As part of the consent order, Evergreen was ordered to pay $395,000 in compensation to minority borrowers who received discriminatory interest rates, and the bank chose to adopt a flat-fee compensation model for its dealers, eliminating dealer discretion and instead paying the dealers a fixed percentage of the amount financed.

The Ally and Evergreen consent orders are an important first step in addressing long-standing discrimination in this market. While dealers should be compensated for their work, we know that some consumers pay much more for the service than others—in fact, some consumers who are able to get the dealer to remove the dealer interest rate markup are subsidized by those who don't. Because the presence of a markup or the amount is never disclosed to the consumer, most consumers are completely unaware of how much of a markup they have paid.

H.R. 1737 would not change fair lending law as it is applied to the auto lending market. Rather, the bill would create an unnecessary and pointless hurdle for the CFPB when issuing guidance to financial institutions on the laws and regulations governing auto finance and what steps lenders can take to comply with them. The CFPB is not required to provide formal guidance, so if the process is too onerous the CFPB can choose not to provide it at all. The law, and the necessity of complying with it, would remain. Further, no good reason exists for a different process for auto lending guidance than for any other consumer finance market. We understand that auto dealers do not favor this guidance, but we should not change the rules of the game for that reason.

Buying a car is extremely important for consumers; after a home a car is often the biggest purchase made by a household. The CFPB has found discriminatory pricing in the auto financing market and should have the ability to use the full range of its regulatory tools to address it. Ultimately, we believe that a CFPB regulation prohibiting financial institutions from involvement in transactions with interest rate markups is the solution to the problem. In the meantime, the steps the CFPB has already taken in this area must be allowed to stand.

Sincerely,

Americans for Financial Reform
Center for Responsible Lending
NAACP
National Consumer Law Center (on behalf of its low income clients)
National Council of La Raza
U.S. PIRG
Woodstock Institute