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CFPB Proposes New Federal Oversight of Nonbank Auto Finance Companies

Bureau Supervision Uncovers Auto-Lending Discrimination at Banks and Obtains $56 Million for Harmed Consumers

WASHINGTON, D.C. – The Consumer Financial Protection Bureau (CFPB) is proposing to oversee larger nonbank auto finance companies for the first time at the federal level. The Bureau also released a supervision report that details the auto-lending discrimination that the Bureau has uncovered at banks. The report highlights that the Bureau's supervisory actions against banks will result in about $56 million in redress for up to 190,000 consumers harmed by discriminatory practices.

"Many people depend on auto financing to pay for the car they need to get to work," said CFPB Director Richard Cordray. "Nonbank auto finance companies extend hundreds of billions of dollars in credit to American consumers, yet they have never been supervised at the federal level. We took action after we uncovered auto-lending discrimination at banks we supervise. Today's proposal would extend our oversight, allowing us to root out discrimination and ensure consumers are being treated fairly across this market."

Cars are indispensable for most working Americans. Nearly 90 percent of the U.S. workforce commutes to work by car. Auto loans are the third largest category of household debt, behind mortgage and student loans. With the average loan for a new car nearing $27,000, American consumers had 87.4 million outstanding auto loans valued at nearly $900 billion in the first quarter of 2014. The leasing market also continues to grow as more than a quarter of new cars are acquired through leases.

Auto loans are financed by both banks and nonbanks. Consumers can either get a loan through direct financing where they seek credit directly from a lender or through indirect financing where an auto dealer typically facilitates a loan from a third party. Banks, credit unions, and nonbank auto finance companies provide credit to consumers both directly and indirectly. Some nonbank finance companies are "captive" nonbanks, meaning finance companies owned by auto manufacturers who generally do only indirect lending.

Currently, the Bureau supervises large banks making auto loans, but not nonbank auto finance companies. Today the CFPB is proposing to extend its supervision authority to the larger participants of the nonbank auto finance market. Under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act), the CFPB has authority to supervise certain nonbanks the Bureau defines through rulemaking as "larger participants" in a market.

Today's proposed rule would generally allow the Bureau to supervise nonbank auto finance companies that make, acquire, or refinance 10,000 or more loans or leases in a year. The Bureau would be supervising them to ensure they are complying with federal consumer financial law. The Bureau estimates that about 38 auto finance companies would be subject to this new oversight. These companies originate around 90 percent of

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nonbank auto loans and leases, and in 2013 provided financing to approximately 6.8 million consumers.

Given the significance of car ownership in the lives of consumers, the CFPB wants to make sure that auto lenders, including auto finance companies, are treating consumers fairly throughout the life of loan by:

- **Fairly marketing and disclosing auto financing:** The Bureau wants to make sure that auto finance companies who market directly to consumers are not using deceptive tactics to market loans or leases. The Bureau would be concerned if consumers are being misled about the benefits or terms of financial products. The Bureau is also looking to ensure that consumers are getting terms they understand and accept.
- **Providing accurate information to credit bureaus:** The Bureau wants to make sure that information provided to the credit bureaus is accurate. The CFPB recently took an enforcement action against an auto finance company that distorted consumer credit records by inaccurately reporting information like the consumer's payment history and delinquency status to credit bureaus. The CFPB is looking to prevent inaccurate information from being reported in the future.
- **Treating consumers fairly when collecting debts:** The Bureau wants to make sure that auto finance companies are not using illegal debt collection tactics. The Bureau has received complaints from consumers who say that their autos have been repossessed while they are current on the loan or have a payment arrangement in place. The Bureau also is looking to ensure that collectors are relying on accurate information and using legal processes when they collect on debts or repossess autos.

Today's proposed rule is open for comment for 60 days after the rule is published in the Federal Register.

Discrimination in the Auto-Lending Market

The CFPB is also concerned about discriminatory pricing in the auto-lending market. When consumers receive indirect financing, often the finance company or other indirect lender authorizes the dealer to mark up the interest rate. Markups lead to dealers and indirect lenders charging different rates to similarly situated consumers, which increases the risk of discrimination. Discriminatory markups on auto loans may result in tens of millions of dollars in consumer harm each year.

In March 2013, the CFPB issued a bulletin reminding indirect auto lenders that under the Equal Credit Opportunity Act (ECOA), it is illegal for a creditor to discriminate in any aspect of a credit transaction on prohibited bases including race, color, religion, national origin, sex, marital status, and age.

Today the Bureau is releasing a new "Supervisory Highlights" report, which details the auto-lending discrimination the CFPB has uncovered at banks under Bureau supervision over the past two years. CFPB examiners found that these indirect auto lenders had discretionary pricing policies that resulted in discrimination against African-American, Hispanic, and Asian and Pacific Islander borrowers. As a result, these borrowers paid more for their auto loans than similarly situated non-Hispanic white borrowers.

When lenders have not followed the law, the Bureau has used both enforcement and supervisory actions to direct institutions to obtain remediation to harmed consumers. Recent non-public CFPB supervisory actions at indirect auto financing institutions resulted in approximately $56 million in remediation for up to 190,000 consumers.

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To prevent discrimination from reoccurring at these lenders, the CFPB has identified at least three possible ways institutions can limit their fair lending risk:

- **Conduct internal monitoring for discrimination:** Auto lenders should monitor and correct for potential discrimination that stems from discretionary pricing policies and address the effects of markup policies as part of a robust fair lending compliance program.
- **Limit discretionary markups:** Indirect auto lenders can reduce the risk of potential discrimination by limiting the discretion dealers have to mark up the price of a loan financed by the lender.
- **Eliminate dealer discretion for markups:** Indirect auto lenders can also lower their fair lending risk by eliminating dealers' ability to markup the price of a loan and fairly compensating dealers using a different mechanism.

Today's supervisory highlights report is available at: http://www.consumerfinance.gov/reports/supervisory-highlights-summer-2014/

Methodology for Evaluating Auto Lending

In order to evaluate a lender's compliance with fair lending laws, CFPB examination teams use a proxy methodology just as other federal supervisory agencies and many private companies do. To proxy for race and national origin, exam teams rely on data associated with consumers' last names and places of residence. Census Bureau data is first used to calculate the probability that an individual belongs to a specific race and ethnicity based on their last name. Exam teams then update that probability based on the demographics of the area in which the person resides again using Census Bureau data.

The CFPB is releasing a white paper which details the precise methodology the Bureau uses to calculate these probabilities, and is also releasing the Bureau's computer code so that lenders can perform the same analysis that the Bureau's examination teams perform. The white paper also reports on a study the Bureau has conducted which finds that the integrated approach to building a proxy is more accurate than either surname or geographic data individually.

More details on the CFPB's proxy methodology for race and national origin can be found at:
http://www.consumerfinance.gov/reports/using-publicly-available-information-to-proxy-for-unidentified-race-and-ethnicity/

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The Consumer Financial Protection Bureau is a 21st century agency that helps consumer finance markets work by making rules more effective, by consistently and fairly enforcing those rules, and by empowering consumers to take more control over their economic lives. For more information, visit ConsumerFinance.gov.