

August 2, 2013

The Honorable Spencer Bachus
U.S. House of Representatives
2138 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Bachus,

Thank you for your letter about indirect auto lending practices and compliance with anti-discrimination laws, such as the Equal Credit Opportunity Act (ECOA). The Consumer Financial Protection Bureau (Bureau) shares your commitment to ensuring that lending practices are fair and equitable and that credit markets function competitively and efficiently for all consumers and honest businesses. We appreciate the opportunity to work with you on these important goals.

The Equal Credit Opportunity Act

In April 2012, the Bureau published a Lending Discrimination Bulletin in which we issued guidance about compliance with the fair lending requirements of the ECOA and its implementing regulation, Regulation B.¹ In the Lending Discrimination Bulletin, the Bureau reaffirmed, consistent with other federal supervisory and law enforcement agencies, including the Department of Justice (DOJ), Federal Trade Commission (FTC), and each of the federal prudential agencies with regulatory authority over financial institutions,² that the legal doctrine of disparate impact remains applicable as the Bureau exercises its supervision and enforcement authority to enforce compliance with the ECOA and Regulation B.

In the Dodd Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank), Congress gave the Bureau the authority to supervise depository institutions with more than \$10 billion in assets and their affiliates, and certain nonbank financial institutions that provide consumer financial products and services, including mortgage, payday, and student lending. The Bureau's supervision for compliance with ECOA includes coverage of indirect auto lending. The Bureau's ongoing supervision of depository institutions and their affiliates currently includes examinations of ECOA compliance in indirect auto lending. Subject to certain exceptions, the Bureau also has enforcement authority over both banks and nonbanks in the auto lending market, and it will use that authority wherever appropriate to address discrimination.

The Bureau's Indirect Auto Bulletin

¹ Lending Discrimination, CFPB Bulletin 2012-04 (Fair Lending), Apr. 18, 2012 available at http://files.consumerfinance.gov/f/201404_cfpb_bulletin_lending_discrimination.pdf.

² Interagency Task Force on Fair Lending, *Policy Statement on Discrimination in Lending*, 59 Fed. Reg. 18,266 (Apr. 15, 1994).

As you know, we published CFPB Bulletin 2013-02, Indirect Auto Lending and Compliance with ECOA, on March 21, 2013 (Indirect Auto Bulletin) to offer guidance to all indirect auto lenders within the jurisdiction of the Bureau, including both depository institutions and nonbank institutions.³ The Bulletin explains that the standard practices of indirect auto lenders likely make them “creditors” under ECOA and that a lender’s discretionary markup and compensation policies may alone be sufficient to trigger liability under ECOA if the lender regularly participates in a credit decision and its policies result in discrimination. By describing the relevant laws and regulations that apply to indirect auto lending, the Bulletin aims to help indirect auto lenders recognize and mitigate the risk of discrimination resulting from discretionary dealer markup and compensation policies.

You have asked why the notice-and-comment rulemaking process was not utilized in publishing the Bureau’s Indirect Auto Bulletin. That process was not necessary for the Bulletin because the Administrative Procedure Act, which sets out the basic principles by which federal agencies engage in regulatory activity, does not mandate notice and comment for general statements of policy, non-binding informational guidelines, or interpretive memoranda.

Certain policies and practices that allow discretion in pricing can create a significant risk of discrimination on the basis of race, national origin, and other prohibited bases such as sex. This risk is acknowledged in the Bureau’s Supervision and Examination Manual. Historically, the failure to properly or consistently monitor such policies and practices for compliance with anti-discrimination laws has been a contributing factor in discrimination, both in auto lending and in other product markets like mortgages. In developing the Bulletin, the Bureau considered a variety of materials, such as ECOA,⁴ its implementing regulation, Regulation B,⁵ the Official Staff Commentary to Regulation B,⁶ CFPB Bulletin 2012-04 (Fair Lending),⁷ CFPB Supervisory Highlights,⁸ and other materials.

The Bureau’s Indirect Auto Bulletin addresses the specific risk of discrimination caused by indirect auto lenders’ discretionary dealer markup and compensation policies. In the course of the Bureau’s supervisory work, we have found frequent instances where lenders had robust fair lending compliance programs for mortgage lending, but weak or non-existent fair lending compliance programs for other types of consumer lending. Yet, the ECOA prohibits discrimination in credit transactions, reaching many different types of consumer lending. As the Bulletin states, lenders may choose to address the risk of discrimination resulting from certain markup and compensation policies in a variety of ways, including: imposing controls on dealer markup and compensation policies; revising these policies to address unexplained pricing disparities on a prohibited basis; eliminating dealer discretion to mark up buy rates and fairly compensating dealers using another mechanism that does not result in discrimination. For all lenders, the Bulletin also emphasizes the need for self-monitoring as a tool to address fair lending risk. It contains additional suggestions for monitoring and corrective action to mitigate that risk,

³ Indirect Auto Lending and Compliance with ECOA, CFPB Bulletin 2013-02, Mar. 21, 2013 *available at* http://files.consumerfinance.gov/f/201303_cfpb_march -Auto-Finance-Bulletin.pdf.

⁴ 15 U.S.C. § 1691 *et seq.*

⁵ 12 C.F.R. pt. 1002.

⁶ 12 C.F.R. pt. 1002 Supp. I.

⁷ Lending Discrimination, CFPB Bulletin 2012-04 (Fair Lending), Apr. 18, 2012 *available at* http://files.consumerfinance.gov/f/201404_cfpb_bulletin_lending_discrimination.pdf.

⁸ Consumer Financial Protection Bureau, *Supervisory Highlights: Fall 2012* (Oct. 31, 2012), *available at* <http://www.consumerfinance.gov/reports/supervisory-highlights-fall-2012>.

including regular analyses to determine whether there are pricing disparities on a prohibited basis across the indirect auto lender's overall portfolio or at the individual dealer level. If differences are found, those analyses may help lenders understand the cause of the disparities as well as potential solutions.

The Indirect Auto Bulletin expressly emphasizes that dealers should be fairly compensated and the guidance offered does not foreclose consumers' ability to negotiate their interest rate on an auto loan.

Analysis of Dealer Markup

Your letter inquired about the details of the "disparate impact methodology" that we use. Our agency is committed to being open and transparent, including in our review of indirect auto lending. The evaluation of whether an indirect auto lender is in compliance with ECOA requires multiple steps.

While fair lending analyses of mortgage lending are simplified by the availability of lender data reported under the Home Mortgage Disclosure Act, this is not the case with indirect auto lending. Information on race, ethnicity, and gender is typically not collected as part of an auto lending transaction. Therefore, the Bureau uses a proxy methodology to differentiate among consumers based upon these characteristics. The concept of using proxies for unavailable data is a widely accepted mathematical and statistical approach used across many disciplines, including, to our understanding, by the auto industry itself for marketing purposes. Various proxy methodologies are publicly available and have been used for decades in a number of different Civil Rights contexts, including voting rights cases, Title VII cases, and constitutional challenges, including jury selection and equal protection matters. In addition, federal banking regulators have made clear that proxy methods may be used in fair lending exams to estimate protected characteristics where direct evidence of the protected characteristic is unavailable.⁹ In keeping with our commitment to transparency, and in line with the approaches of other federal regulators, the Bureau has previously indicated that when we utilize proxy data, we use surnames and geographic location. The Bureau conducts its proxy analysis by using publicly available data from the Social Security Administration and the Census Bureau. We understand that many responsible lenders regularly use proxies in their own fair lending analyses where self-reported race, ethnicity, and gender data are unavailable. There are a variety of proxy methods, and the Bureau has encouraged lenders who are not currently doing so to select a reasonable proxy method that is suitable for their nature, size, and complexity and to monitor their data for fair lending risk.

Each supervisory examination or enforcement investigation is based on the particular facts presented. Thus, in our analyses we consider analytical controls which are appropriate to each particular case in reviewing data to determine whether a specific policy results in disparities. When lenders share with us the nature and results of their own analyses, we are open to hearing specific explanations for the decisions they have made to include particular analytical controls that reflect a legitimate business need. In evaluating whether pricing disparities exist in dealer markup, we typically look to whether there is a statistically significant basis point disparity in the dealer markups received by the prohibited basis group as compared to the control group. The

⁹ See *Interagency Fair Lending Examination Procedures*, at 12-13, available at <http://www.ffiec.gov/PDF/fairlend.pdf> (explaining that "[a] surrogate for a prohibited basis group may be used" in a comparative file review and providing examples of surname proxies for race/ethnicity and first name proxies for sex); see also <http://www.philadelphiafed.org/bank-resources/publications/consumer-compliance-outlook/2012/first-quarter/fair-lending-webinar.cfm>.

Bureau considers on a case-by-case basis whether disparities identified in the data, when considered in view of all other evidence, support a violation of ECOA.

Interagency Coordination

Finally, you have asked for information about the Bureau's coordination with other federal agencies with ECOA responsibilities. The Bureau coordinates closely with the DOJ and other federal agencies to ensure that our fair lending enforcement efforts are consistent, efficient, and effective. For example, the Department of Justice and the Bureau signed a Memorandum of Understanding on December 6, 2012 to strengthen coordination on fair lending enforcement and avoid duplication of our respective federal law enforcement efforts.¹⁰ The FFIEC agencies all report substantial outreach and interagency activity aimed at ensuring creditors' compliance with ECOA and Regulation B, and that fair lending laws are enforced in a consistent and fair manner. The CFPB, along with the DOJ and the Federal Reserve Board of Governors, among others, serve as co-chairs of the Federal Financial Fraud Enforcement Task Force's Non-Discrimination Working Group, which is presenting a webinar on auto lending in August. The CFPB meets regularly with the DOJ, the prudential regulators, and the FTC to discuss ongoing fair lending supervision and enforcement activities, as appropriate. These regular discussions are designed to ensure that supervision and enforcement efforts are well-coordinated.

Thank you for bringing your concerns to the Bureau's attention and for the opportunity to respond. We look forward to working with you on this important issue of economic fairness as we continue to work to help markets operate more effectively for consumers and businesses alike.

Sincerely,



Richard Cordray
Director

cc: The Honorable Shelley Moore Capito
The Honorable Gary Miller
The Honorable Lynn A. Westmoreland
The Honorable Scott Garrett
The Honorable Randy Neugebauer
The Honorable Patrick T. McHenry
The Honorable John Campbell
The Honorable Peter T. King
The Honorable Edward R. Royce
The Honorable Michele Bachmann
The Honorable Stevan Pearce
The Honorable Blaine Luetkemeyer
The Honorable Bill Huizenga
The Honorable Sean P. Duffy

¹⁰ Memorandum of Understanding between the Consumer Financial Protection Bureau and the United States Department of Justice (Dec. 6, 2012), available at http://files.consumerfinance.gov/f/201212_cfpb_doj-fair-lending-mou.pdf.

The Honorable Robert Hurt
The Honorable Michael G. Grimm
The Honorable Steve Stivers
The Honorable Stephen Fincher
The Honorable Marlin A. Stutzman
The Honorable Mick Mulvaney
The Honorable Dennis A. Ross
The Honorable Robert Pittenger
The Honorable Ann Wagner
The Honorable Garland “Andy” Barr
The Honorable Tom Cotton
The Honorable Keith L. Rothfus
The Honorable Tom Latham
The Honorable Jack Kingston
The Honorable Steve King
The Honorable Mark Meadows
The Honorable Steve Stockman
The Honorable George Holding
The Honorable Walter Jones
The Honorable Tom Marino