Banking and Finance Law Daily Wrap Up,TOP STORY—CFPB Guides on ECOA Compliance for Indirect Auto Lenders,(Mar. 21, 2013)

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The Consumer Financial Protection Bureau has issued guidance intended to assist indirect auto lenders with Equal Credit Opportunity Act compliance. The guidance is directed toward auto lenders that permit dealers to increase consumer interest rates and compensate dealers with a share of the increased interest revenues (CFPB Bulletin 2013-02, March 21, 2013). The guidance applies to both depository and nonbank institutions.

Indirect auto financing. In indirect auto financing, the dealer generally collects information about the applicant and uses an automated system to forward that information to several prospective indirect auto lenders. After evaluating the applicant, indirect auto lenders may choose not to become involved in the transaction or they may choose to provide the dealer with a risk-based "buy rate" that establishes a minimum interest rate at which the lender is willing to purchase the retail installment sales contract for the purchase of the automobile.

The indirect auto lender also may have a policy that allows the dealer to mark up the interest rate above the indirect auto lender's buy rate. If the dealer charges the consumer an interest rate that is higher than the lender's buy rate, the lender may pay the dealer "reserve," compensation based on the difference in interest revenues between the buy rate and the actual note rate charged to the consumer in the retail installment contract. Dealer reserve is one method lenders use to compensate dealers for the value they add by originating loans and finding financing sources.

Because of the incentives these markup and compensation policies create, and the discretion they permit, the CFPB believes that there is a significant risk that they will result in pricing disparities on the basis of race, national origin, and other prohibited bases.

ECOA considerations. The ECOA prohibits a creditor from discriminating in any aspect of a credit transaction on the basis of race, color, religion, national origin, sex, marital status, age, receipt of income from a public assistance program, or the good faith exercise of a right under the Consumer Credit Protection Act.

A creditor is defined by the ECOA as "any person who regularly extends, renews, or continues credit." A creditor also includes an assignee of an original creditor who participates in the decision to extend, renew, or continue credit.

Even as assignees of the installment contract, indirect auto lenders are creditors under the ECOA and Reg. B-Equal Credit Opportunity (12 CFR 1002) if, in the ordinary course of business, they regularly participate in a credit decision. According to the bureau, the practices of indirect auto lenders likely constitute participation in a credit decision under the ECOA and Reg. B.

Liability for discrimination. A consideration for auto lenders covered as creditors under the ECOA is whether and under what circumstances they are liable for pricing disparities on a prohibited basis. When such disparities exist within an indirect auto lender's portfolio, lenders may be liable under the legal doctrines of both disparate treatment and disparate impact.

An indirect auto lender's markup and compensation policies alone may be sufficient to trigger liability under the ECOA if the lender regularly participates in a credit decision and its policies result in discrimination. The disparities triggering liability could arise within a particular dealer's transactions or across different dealers within the lender's portfolio. Therefore, an indirect auto lender that permits dealer markup and compensates dealers on that basis may be liable for these policies and practices if they result in disparities on a prohibited basis, according to the CFPB.

The CFPB cautions that some indirect auto lenders may be making an incorrect assumption that they are not liable under the ECOA for pricing disparities caused by markup and compensation policies because Reg. B provides that "[a] person is not a creditor regarding any violation of the [ECOA] or [Regulation B] committed by another creditor unless the person knew or had reasonable notice of the act, policy, or practice that constituted the violation before becoming involved in the credit transaction." While this provision limits a creditor's liability for another creditor's ECOA violations under certain circumstances, it does not limit a creditor's liability for its own violations, including disparities on a prohibited basis that result from the creditor's own markup and compensation policies, the bureau said.

Limiting liability. The CFPB suggests that indirect auto lenders subject to the bureau's jurisdiction should take certain steps to ensure that they are in compliance with the ECOA and Reg. B, including:

- imposing controls on dealer markup and compensation policies, revising current policies, and monitoring the effects of those policies; or
- eliminating dealer discretion to mark up buy rates and fairly compensating dealers in another manner that does not result in discrimination, such as a flat fee per transaction.

The CFPB also recommends that indirect auto lenders develop a strong fair lending compliance management program that includes:

- a current fair lending policy statement;
- regular fair lending training for employees involved with any credit transactions as well as all officers and board members;
- ongoing monitoring for compliance with fair lending policies and procedures;
- ongoing monitoring for compliance with other policies and procedures that are intended to reduce fair lending risk;
- regular review of lending policies for potential violations;
- regular analysis of loan data in all product areas for potential disparities;
- regular assessment of the marketing of loan products; and

- meaningful oversight of fair lending compliance by management and, if appropriate, the institution’s board of directors

The CFPB bulletin also included additional steps that may be necessary for some lenders to take in order to comply with ECOA and Reg. B. provisions.

In conjunction with the bulletin, the bureau issued a factsheet and an infographic on auto lending posted to its blog.

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