Unsafe at Any Bureaucracy:

CFPB Junk Science and Indirect Auto Lending

Report Prepared by the Republican staff of the
Committee on Financial Services, U.S. House of Representatives

Hon. Jeb Hensarling, Chairman

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Executive Summary

Since at least February 2012, the Bureau of Consumer Financial Protection (Bureau), and in particular its Office of Fair Lending and Equal Opportunity, has engaged in an aggressive effort to enforce the Equal Credit Opportunity Act (ECOA) against vehicle finance companies using a controversial theory of liability known as disparate impact. In doing so, it has attempted to implement a "global solution" that enlists these companies in an effort to alter the compensation of automobile dealers, over which the Bureau has no legal authority.

As internal documents obtained by the Financial Services Committee and accompanying this report reveal, the Bureau's ECOA enforcement actions have been misguided and deceptive. The Bureau ignores, for instance, the lack of congressional intent to provide for disparate impact liability under ECOA, just as it ignores the fact that indirect auto finance companies are not always subject to ECOA and have a strong business justification defense.

In addition, memoranda reveal that senior Bureau officials understood and advised Director Richard Cordray on the weakness of their legal theory, including: (1) that the practice the Bureau publicly maintained caused discrimination – allowing auto dealers to charge retail interest rates to customers – may not even be recognized as actionable by the Supreme Court; (2) that it knew that the controversial statistical method the Bureau employed to measure racial disparities is less accurate than other available methods and prone to significant error, including that for every 100 African-American applicants in a data set for which race was known, the Bureau's proxy method could only identify roughly 19 of them as African-Americans; and (3) that the Bureau knew that factors other than discrimination were causing the racial disparities it observed, but refused to control for such factors in its statistical analysis.

Notwithstanding the weakness of its case, the Bureau pursued its radical enforcement strategy using "unfair, abusive, and deceptive" tactics of its own, including by making an example of a company over which it had significant political leverage and concealing other aspects of its efforts from public scrutiny. The purpose of this report is to provide the public with a better understanding of the Bureau's activities.

Legal Background

Title X of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) established the Bureau as an independent executive agency.[1] Dodd-Frank gave the Bureau the authority to supervise depository institutions with more than $10 billion in assets and their affiliates,[2] as well as certain nonbank financial institutions that provide consumer financial products and services, including mortgage, payday, and student lending.[3] The Bureau also has supervisory authority over "larger participant[s] of a market for other consumer financial products or services" as the Bureau defines by rule.[4]

Notably, Section 1029 of Dodd-Frank granted certain automobile dealers immunity from almost any Bureau action, specifying that "the Bureau may not exercise any rulemaking, supervisory, enforcement or any other authority, including any authority to order assessments, over a motor vehicle dealer that is predominantly engaged in the sale and servicing of motor vehicles."[5] This comprehensive safe harbor is rare in Dodd-Frank, which exempts other industries and entities, such as insurance companies, from the Bureau's supervisory and rulemaking authority, but still allows the Bureau to bring enforcement actions against them if they violate any consumer protection laws while

[1] Dodd–Frank Wall Street Reform and Consumer Protection Act [hereinafter Dodd–Frank Act] § 1011, 12 U.S.C. § 5491 (2012).
[2] *Id.* § 1025(a).
[3] *Id.* § 1024(a)(1)(A), (D), (E).
[4] *Id.* § 1024(a)(1)(B), (a)(2); *see also id.* § 1002(5) (defining "consumer financial product or service") (defining "consumer financial product or service"). On June 5, 2015, the Bureau issued a final rule defining larger participants in the automobile financing market. *See* http://files.consumerfinance.gov/f/201506_cfpb_defining-larger-participants-of-the-automobile-financing-market-and-defining-certain-automobile-leasing-activity-as-a-financial-product-or-service.pdf.
[5] § 1029(a).

offering financial products or services.[6] Under Section 1029, the Bureau cannot directly regulate auto dealers or bring enforcement actions against them.[7]

Dodd-Frank granted the Bureau authority to implement and enforce several enumerated Federal consumer financial laws. One such law is ECOA.[8] When originally enacted in 1974, ECOA gave the Federal Reserve Board responsibility for prescribing and enforcing the implementing regulation, Regulation B. Dodd-Frank transferred rule-making authority under ECOA to the Bureau.[9] With respect to entities within its jurisdiction, Dodd-Frank granted the Bureau authority to supervise for and enforce compliance with ECOA.[10]

As originally enacted, ECOA made it unlawful for "any creditor to discriminate against any applicant on the basis of sex or marital status with respect to any aspect of a credit transaction."[11] Two years later in 1976, Congress amended ECOA to include additional categories of prohibited discrimination: race, color, religion, national origin, age, (if the applicant is old enough to enter into a contract), receipt of public assistance benefits, or the exercise of rights under the Consumer Credit Protection Act.[12] ECOA defines "creditor" as "any person who regularly extends, renews, or continues credit; any person who regularly arranges for the extension, renewal, or continuation of credit; or any

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[6] *See id.* § 1027(f) (exempting insurance companies).
[7] The lone exception is "Buy Here, Pay Here" dealers, who are automobile dealers who finance vehicle purchase contracts without assigning them to third parties. See *id.* § 1029(b).
[8] 15 U.S.C. § 1691 *et. seq.*
[9] In December 2011, the Bureau restated the Federal Reserve's implementing regulation at 12 C.F.R. Part 1002 *et seq.* See 76 Fed. Reg. 79442 (Dec. 21, 2011). The Federal Reserve retains such authority with regard to dealers covered by the § 1029(b) exclusion.
[10] Dodd–Frank Act § 1085. Other agencies may also enforce ECOA against companies within their respective jurisdictions.
[11] *Id.* § 503.
[12] See Pub. L. 94-239, 90 Stat. 251 § 2 (1976).

assignee of an original creditor who participates in the decision to extend, renew, or continue credit."[13]

Section 1013(c)(1) of Dodd-Frank established within the Bureau an Office of Fair Lending and Equal Opportunity. This office is responsible for overseeing and enforcing Federal fair lending laws, including ECOA, and coordinating the Bureau's fair lending efforts with other Federal agencies.[14]

On January 4, 2012, President Obama announced the recess appointment of Richard Cordray, a former Ohio Attorney General, to serve as Director of the Bureau.[15] On February 20, 2012, Mr. Cordray approved the creation of an "Auto Finance Discrimination Working Group" within the Bureau.[16] The Working Group's charter noted that "[c]onsumer advocates, including the National Consumer Law Center (NCLC) and the Center for Responsible Lending (CRL) have focused on abuses in auto finance" and that "consumer advocates argue that dealer markups also may constitute an unfair practice."[17] The Working Group pledged to develop a work plan to "evaluate the scope of dealer markups . . . in the auto finance industry and quantify the harm to consumers" and analyze "whether caps on dealer markups still exist and whether the presence of such caps reduces or eliminates the risk of discrimination."[18] The Working Group was charged with making

[13] 15 U.S.C. § 1691a.

[14] 12 U.S.C. § 5493(c)(2)(A), (B).

[15] Three other recess appointments made by the President on the same day and in the same manner were subsequently invalidated by the U.S. Supreme Court in *National Labor Relations Board v. Noel Canning*, because the appointment was not made during a recess of the Senate. 134 S. Ct. 2550, 2578 (2014). Director Cordray's recess appointment is currently being challenged in *State National Bank of Big Spring v. Lew*., 795 F.3d 48, 57 (D.C. Cir. 2015) (remanding the case to the district court).

[16] *See* February 20, 2012, Decision Memorandum. At the time, Mr. Cordray acted under color of office although he did not meet the statutory requirements of his office, since the Senate had not confirmed his nomination nor had he been validly recess-appointed.

[17] *Id.* at 2.

[18] *Id.* at 5–6.

recommendations for further action to the Bureau's Policy Committee.[19] Responsibility for overseeing the Working Group's progress and approving its recommendations was assigned to a Steering Committee chaired by Patrice Ficklin, the Bureau's Assistant Director for Fair Lending.[20]

Disparate Impact under ECOA

Disparate impact is a controversial legal theory of liability in discrimination cases. In contrast to a disparate treatment case, where a "plaintiff must establish that the defendant had a discriminatory intent or motive," a plaintiff bringing a disparate impact claim challenges practices that have a "disproportionately adverse effect on minorities" and are otherwise unjustified by a legitimate rationale.[21] In other words, disparate impact holds that a law or regulation may prohibit a practice that is discriminatory in effect because it has a disproportionately negative impact on a prohibited basis, even though the defendant has no intent to discriminate and the practice appears neutral on its face.

On April 18, 2012, the Bureau published a bulletin to provide guidance about compliance with ECOA and Regulation B.[22] The bulletin asserted that the Bureau "reaffirms 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."[23] Notably, the only authorities the Bureau cited to support its assertion that disparate impact claims are cognizable under ECOA were pronouncements made by

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[19] *Id.* at 6.
[20] *Id.* at 7.
[21] *Texas Dep't of Hous. and Comty. Affairs v. The Inclusive Communities Project, Inc.*, 135 S.Ct. 2507, 2513 (2015) (quoting *Ricci v. DeStefano*, 557 U.S. 557, 577 (2009) (internal quotation marks omitted)).
[22] Consumer Financial Protection Bureau, *Bureau Bulletin 2012-04 (Fair Lending)* (Apr. 18, 2012), *available at* http://files.consumerfinance.gov/f/201404_Bureau_bulletin_lending_discrimination.pdf.
[23] *Id.* at 1.

other federal agencies:[24] (1) a 1994 interagency policy statement,[25] (2) a provision of Regulation B originally adopted by the Federal Reserve,[26] and (3) an Official Staff Commentary to Regulation B, also originally adopted by the Federal Reserve.[27]

The 1994 interagency "Policy Statement on Discrimination in Lending" noted that courts had recognized three methods of demonstrating lending discrimination under the ECOA and the Fair Housing Act (FHA), one of which was disparate impact.[28] However, as explained more fully below, the court cases referenced in the policy statement have been called into question by recent U.S. Supreme Court decisions.[29] Accordingly, it is far from clear that the policy statement continues to carry any precedential or legal effect.

Regarding the two other authorities referenced by the Bureau in its bulletin, the provisions authored by the Federal Reserve are themselves derived from House and Senate

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[24] Public statements by Director Cordray regarding this bulletin similarly rely on vague assertions of legal authority. *See, e.g.*, Richard Cordray, *Director Cordray Remarks at the CFPB Auto Finance Forum* (Nov. 14, 2013) ("Over the years, Congress has made findings and has enacted laws to identify and root out differential treatment of Americans in the marketplace based on gender, race, national origin, and other protected characteristics. . . . Last year, we issued a bulletin providing guidance that the Bureau would consider evidence of disparate impact as one method of proving discrimination under federal fair lending law. There was nothing new in what we said at that time. In fact, we were simply making the statement that as a new federal agency we too would be joining with our sister regulatory agencies and the Department of Justice in acknowledging and reaffirming the existing law of the land.") http://www.consumerfinance.gov/newsroom/director-cordray-remarks-at-the-cfpb-auto-finance-forum/.

[25] *See* Interagency Task Force on Fair Lending, *Policy Statement on Discrimination in Lending*, 59 Fed. Reg. 18, 266 (Apr. 15, 1994), *available at* www.occ.treas.gov/news-issuances/federal-register/94fr9214.pdf.

[26] *See* 12 C.F.R. § 1002.6(a) (asserting that "[t]he legislative history of the Act indicates that the Congress intended an 'effects test' concept, as outlined in the employment field by the Supreme Court in the cases of *Griggs v. Duke Power Co.*, 401 U.S. 424 (1971), and *Albemarle Paper Co. v. Moody*, 422 U.S. 405 (1975), to be applicable to a creditor's determination of creditworthiness."). The Bureau adopted this language verbatim from the Federal Reserve's prior version of Regulation B. *See* 12 C.F.R. § 202.6(a) n.2 (2005).

[27] *See* 12 C.F.R. pt. 1002, Supp. I, § 1002.6, ¶ 6(a)-2. The Bureau adopted this Commentary from the prior Federal Reserve Commentary to Regulation B. The Staff Commentary asserts that "Congressional intent that this doctrine apply to the credit area is documented in the Senate Report that accompanied H.R. 6516, No. 94-589, pp. 4-5; and in the House Report that accompanied H.R. 6516, No. 94-210, p. 5."

[28] *Id.*

[29] The U.S. Court of Appeals for the District of Columbia in *Garcia v. Johanns*, 444 F.3d 624 (D.C. Cir. 2006), has questioned whether ECOA supports a disparate impact claim in light of *Smith v. City of Jackson*, 544 U.S. 228 (2005). The recent case of *Texas Dep't of Hous. & Cmty. Affairs v. The Inclusive Communities Project, Inc.*, 135 S. Ct. 2507 (2015), further calls into question whether ECOA supports a disparate impact claim.

Committee reports dated May 14, 1975 and January 21, 1976, respectively.[30] However, citing these reports as indicia of Congressional intent in support of disparate impact liability under ECOA is inapt. As originally enacted in 1974, ECOA made it "*unlawful for any creditor to discriminate against any applicant on the basis of* sex or marital status."[31] As already mentioned, in 1976, Congress amended ECOA to expand the prohibited bases beyond sex and marital status to include race and other attributes. However, the 1976 amendments did not modify the underlying discrimination proscription; ECOA, as amended, continued to make it "*unlawful for any creditor to discriminate against any applicant on the basis of*" a broader list of specified attributes. Thus, the reports cited by the Federal Reserve in Regulation B relate not to the initial enactment of ECOA, but to the subsequent amendments made two years later. In fact, the House and Senate Committee reports accompanying the original ECOA legislation make no reference whatsoever to disparate impact.[32] It is therefore doubtful that these two authorities relied upon by the Bureau are probative of congressional intent.[33] To the contrary, the absence of legislative history from 1974 cited by the Bureau to support its assertion, coupled with the fact that in amending ECOA two years later, Congress chose not to alter ECOA's discrimination proscription to explicitly encompass disparate impact claims, supports the conclusion that Congress did not intend for disparate impact claims to be cognizable under ECOA.

[30] H.R. REP. NO. 94-210 (1975) and S. REP. NO. 94-589 (1976).
[31] Pub. L. No. 93-495, 88 Stat. 1521.
[32] *See* H.R. REP. NO. 94-210 (1975); S. REP. NO. 94-589 (1976); H.R. REP. NO. 94-873 (1976) (Conf. Rep.).
[33] Indeed, the Supreme Court has declined to treat comments by a subsequent Congress as legislative history because it is "a hazardous basis for inferring the intent of Congress." *See Jones v. United States*, 526 U.S. 277, 238 (1999).

This conclusion is also supported by the text of ECOA itself, which would be the first consideration of a reviewing court.[34] The Bureau's bulletin made no argument in support of the Bureau's authority based on the statutory text of ECOA. The United States Supreme Court has never decided whether the disparate impact theory of liability is cognizable under ECOA. However, the Supreme Court has evaluated whether disparate impact is cognizable under other statutes, and these decisions are instructive.

In *Griggs v. Duke Power*, an employment discrimination case decided before Congress enacted ECOA, the U.S. Supreme Court examined whether Section 703(a)(2) of the Civil Rights Act of 1964 permitted disparate impact liability claims. The statute provided:

> "It shall be an unlawful employment practice for an employer . . . to limit, segregate, or classify his employees . . . in any way which would deprive or tend to deprive any individual of employment opportunities *or otherwise adversely affect* his status as an employee, because of such individual's race. . . ."[35]

Explaining that Congress had "directed the thrust of the Act to the consequences of employment practices, not simply the motivation,"[36] the Court held that "the [disparate impact] objective of Congress in the enactment of [Section 703(a)(2)] is plain from the language of the statute."[37]

[34] *See Gross v. FBL Financial Services, Inc.*, 129 S.Ct. 2343, 2350, 174 L.Ed.2d 119 (2009) ("Statutory construction must begin with the language employed by Congress and the assumption that the ordinary meaning of that language accurately expresses the legislative purpose") (internal quotation marks omitted).
[35] *Griggs v. Duke Power Co.*, 401 U.S. 424, 426 n.1 (U.S. 1971) (quoting 42 U.S.C. § 2000e-2(a)(2)).
[36] *Id.* at 432.
[37] *Id.* at 429.

In *Smith v. City of Jackson*, the Supreme Court similarly examined whether the Age Discrimination in Employment Act of 1967 (ADEA) permitted disparate impact claims.[38] As enacted, section 4(a)(2) of the ADEA provided:

> "It shall be unlawful for an employer . . . to limit, segregate, or classify his employees . . . in any way which would deprive or tend to deprive any individual of employment opportunities *or otherwise adversely affect* his status as an employee, because of such individual's age. . . ."[39]

Noting that this statutory language was nearly identical to that examined by the Court in *Griggs*, the Court again conducted a textual analysis of the statute and concluded that, like the Civil Rights Act of 1964, the ADEA's "text focuses on the *effects* of the action on the employee rather than the motivation for the action of the employer."[40] Accordingly, a plurality of the Court concluded that the ADEA similarly permitted disparate impact claims.[41]

Most recently, in *Texas Department of Housing and Community Affairs v. Inclusive Communities Project, Inc*., the Supreme Court examined whether the Fair Housing Act (FHA) permitted disparate impact claims.[42] Section 804(a) of the FHA provided:

> "It shall be unlawful . . . To refuse to sell or rent after the making of a bona fide offer, or to refuse to negotiate for sale or rental of, *or otherwise make unavailable* or deny, a dwelling to any person because of race, color, religion, sex, familial status, or national origin."[43]

In its syllabus, the Court announced a rule that "[u]nder [*Griggs*] and [*Smith*], antidiscrimination laws should be construed to encompass disparate-impact claims when their text refers to the consequences of actions and not just to the mindset of the actors,

[38] 544 U.S. 228 (2005).
[39] § 4(a)(2), 81 Stat. 603 (1967).
[40] *Smith*, 544 U.S. at 236.
[41] *Id.* at 240.
[42] *Texas Dep't of Hous. & Cmty. Affairs v. The Inclusive Communities Project, Inc*., 135 S. Ct. 2507 (2015).
[43] 42 U.S.C. § 3604(a) (emphasis added).

and where that interpretation is consistent with the statutory purpose."[44] Applying this rule to its examination of the FHA, the Court noted that "Congress' use of the phrase 'otherwise make unavailable' refers to the consequences of an action rather than the actor's intent."[45] The Court thus concluded that "this results-oriented language counsels in favor of recognizing disparate-impact liability."[46] Moreover, the Court compared the structure of the FHA to the Civil Rights Act and ADEA and noted that their "otherwise adversely affect" language is equivalent in function and purpose to the FHA's "otherwise make unavailable" language:

> "In these three statutes the operative text looks to results. The relevant statutory phrases, moreover, play an identical role in the structure common to all three statutes: Located at the end of lengthy sentences that begin with prohibitions on disparate treatment, they serve as catchall phrases looking to consequences, not intent. And all three statutes use the word 'otherwise' to introduce the results-oriented phrase. 'Otherwise' means 'in a different way or manner,' thus signaling a shift in emphasis from an actor's intent to the consequences of his actions."[47]

ECOA, to the contrary, contains no such consequences-based language. Rather, the discrimination proscription in ECOA focuses solely on the intent of the actor. Following *Inclusive Communities*, a textual comparison of ECOA with the Civil Rights Act, the ADEA, and the FHA reveals that it is far from certain that disparate impact claims are cognizable under ECOA:

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[44] *The Inclusive Communities Project, Inc.*, 135 S. Ct. at 2511.
[45] *Id.* at 2518 (citation omitted).
[46] *Id.*
[47] *Id.* at 2519 (citation omitted).

Statute	CRA	ADEA	FHA	ECOA
Supreme Court Case	*Griggs*	*Smith*	*Inclusive Communities*	
Disparate Treatment Proscription	It shall be an unlawful employment practice for an employer—(1) to fail or refuse to hire or to discharge any individual, or otherwise to ***discriminate against*** any individual with respect to his compensation, terms, conditions, or privileges of employment, ***because of*** such individual's race, color, religion, sex, or national origin; or	It shall be unlawful for an employer—(1) to fail or refuse to hire or to discharge any individual or otherwise ***discriminate against*** any individual with respect to his compensation, terms, conditions, or privileges of employment, ***because of*** such individual's age;	805(a): (a) In general It shall be unlawful for any person or other entity whose business includes engaging in residential real estate-related transactions to ***discriminate against*** any person in making available such a transaction, or in the terms or conditions of such a transaction, ***because of*** race, color, religion, sex, handicap, familial status, or national origin.	(a) It shall be unlawful for any creditor to ***discriminate against*** any applicant ***on the basis of*** sex or marital status with respect to any aspect of a credit transaction.
Disparate Impact Proscription	(2) to limit, segregate, or classify his employees…in any way which would deprive or tend to deprive any individual of employment opportunities ***or otherwise adversely affect*** his status as an employee, because of such individual's race…"	(2) to limit, segregate, or classify his employees in any way which would deprive or tend to deprive any individual of employment opportunities ***or otherwise adversely affect*** his status as an employee, because of such individual's age;	804(a): It shall be unlawful…To refuse to sell or rent after the making of a bona fide offer, or to refuse to negotiate for the sale or rental of, ***or otherwise make unavailable*** or deny, a dwelling to any person because of race, color, religion, sex, familial status, or national origin.	**NO STATUTORY COUNTERPART**
Disparate Impact Cognizable?	**YES**	**YES**	**YES**	**?**

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[48] *See generally* Peter Cubita and Michelle Hartmann, *The ECOA Discrimination Proscription and Disparate Impact—Interpreting the Meaning of the Words That Actually are There*, 61 THE BUS. LAWYER 829 (2006) http://www.weil.com/~/media/files/pdfs/ecoadiscrim.pdf.

Indirect Auto Lending

To understand the Bureau's approach to enforcing ECOA, it is important to examine the nature of the market for auto financing and identify the faulty assumptions underlying the Bureau's enforcement actions.

In a typical automobile purchase, a prospective customer can negotiate several deal points, including the price of the car, a service package, the value of a trade-in, and financing. Most dealers offer vehicle financing as a convenience to customers. Vehicle financing can take several forms. "Buy here-pay here" dealers finance transactions in-house. Other dealers may have relationships with "indirect auto lenders,"[49] which are assignee creditors that may be banks, captive finance companies,[50] or independent finance companies.

Prospective car buyers are not bound to accept vehicle financing offered by a dealer. They are free to leave and shop for a better deal, or to negotiate for better terms.[51] Aspects of the financing that are typically negotiated include the amount to be financed, the interest rate, the length of the credit contract, and the monthly payment schedule. And even after a dealer quotes them an interest rate, buyers are free to decline the rate, make a lower offer,

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[49] Bureau documents describe these finance companies as "indirect auto *lenders*," although they are more appropriately described as creditors rather than lenders pursuant to state laws.

[50] Captive finance companies are subsidiaries whose purpose is to provide financing to customers buying the parent company's product.

[51] Director Cordray apparently takes a dim view of consumer freedom in this regard, claiming the following:

> "When consumers set out to bring home a car or truck, the process can be uniquely complex as it encompasses many decisions. First, people have to pick out their vehicle of choice – the make, the model, the price, and its features. At some point, they may encounter certain add-on products such as a warranty, rustproofing, roadside protection, service plans, and more. By the time they have made all those choices, they may be invested in the car and impatient to finish up and drive it home. Financing can come to seem like almost an afterthought or a mere detail, rather than a key product in its own right. Consumers may have very little sense of what financing options are available beyond the first deal described to them."

Richard Cordray, *Prepared Remarks of CFPB Director Richard Cordray at the Auto Finance Field Hearing* (Sept. 18, 2014), http://www.consumerfinance.gov/newsroom/prepared-remarks-of-cfpb-director-richard-cordray-at-the-auto-finance-field-hearing/.

arrange for financing through other means, pay cash, or walk away. However, if a buyer and dealer can come to a mutually satisfactory deal, they execute a contract known as a "Retail Installment Sale Contract" (RISC) that memorializes the financing terms, including the retail interest rate to be paid by the borrower.

Indirect auto creditors exist in order to help dealers meet customer demand for vehicle financing. Either before or after entering into a RISC with a car buyer, dealers can solicit bids from these creditors to purchase the RISC.[52] Dealer requests for bids contain information from a prospective borrower's credit application (which by law excludes race, national origin and other demographic information) to help the indirect creditor evaluate the bid. After reviewing the requests from the dealer, indirect creditors (prospective assignees) independently decide whether they are willing to purchase from the dealer the RISC executed or to be executed by the car buyer and inform the dealer whether they are willing to do so, and at what price. Dealers that submit requests for bids often receive several responses from various creditors prior to entering into a RISC. Indirect creditors compete for dealer business on a variety of terms, including interest rate, amount advanced, and contract term allowed.[53]

Dealers are able to obtain a discounted "wholesale" interest rate for the purchase of a RISC from indirect creditors because of the large volume of credit applications they control and the origination costs they save for the creditors. Dealers are also able to arrange financing for borrowers that the borrowers couldn't arrange for themselves by

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[52] Purchasing the RISC means extending financing in exchange for the future income stream of finance payments made by the car buyer. The assignee becomes the owner of the RISC.

[53] AFSA 2014 Working Paper, *The Consumer Financial Protection Bureau (CFPB) threatens Small Business*, AUTOS AND ECONOMICS (Mar. 7, 2014), http://autosandeconomics.blogspot.com/2014/03/the-consumer-financial-protection html#more.

combining less attractive deals with more attractive deals and shopping the package to creditors.[54] Often this results in the approval of a borrower who might not otherwise have been able to find financing, or in a borrower obtaining a lower interest rate than they could get on their own.

The difference between the retail rate accepted by the buyer and the wholesale rate quoted by creditors to the dealer is known as "dealer participation" and constitutes the dealer's retail margin. Dealers try to maintain a retail margin to cover the costs of their origination operation and provide a return.[55] Most creditors typically decline to purchase RISCs if the amount of retail margin generally exceeds two or two-and-a-half percent, depending upon the length of the credit contract. Creditors and dealers also agree on the disposition of revenue from the retail margin that would be realized if the RISC earned out over the full term of the contract. This revenue, discounted for present value and distributed as a lump sum up front, is known as "dealer reserve." Sometimes creditors pay dealers the dealer reserve in full. However, because some car buyers pay off their RISC early (and some others default), the full amount of interest revenue is sometimes unearned. In such cases, dealers would be obligated to repay creditors a portion of the unearned dealer reserve. Consequently, creditors typically offer to bear the risks of prepayment or default for the dealer in exchange for a percentage of the Dealer Reserve otherwise due to the dealer.

[54] *See id.*
[55] This is typical of any retail operation, which acquires goods at wholesale cost and sells them at retail cost. Consumers benefit from the convenience of shopping for many goods in one place locally rather than having to source all goods from individual manufacturers.

Dealer financing thus provides convenience to customers, saves creditors time and money, and allows more vehicles to be sold.[56] However, the Bureau characterizes dealer financing very differently. The Bureau views the discounted wholesale rate quoted to dealers by creditors as the interest rate to which car buyers should be entitled.[57] Using the discounted wholesale rate as a baseline, the Bureau then considers any difference between the baseline and retail interest rate agreed to by a borrower as a "mark up."[58] The Bureau also views the payment of dealer reserve to dealers for originating the RISC as a form of compensation that *incentivizes* dealer "mark ups."[59] In the Bureau's view, a creditor's failure to influence or outright control the terms of the RISC freely agreed to by the car buyer and the dealer constitutes a "policy" of permitting dealer "discretion" in setting retail interest rates.[60] Such "discretion," the Bureau asserts, presents a risk of pricing disparities on the basis of race, national origin, and other prohibited bases, and thus subjects indirect auto creditors to potential disparate impact liability under ECOA.[61] However, the Bureau acknowledges internally that so-called "mark ups" are a common retail practice, and the Bureau even elected not to pursue a rulemaking on the ground that a rule "would provide little principled basis on which to distinguish markup from other, similar practices that are ubiquitous in retail transactions."[62]

[56] *See* AFSA 2014 Working Paper.
[57] *See* Richard Cordray, *Director Cordray Remarks at the CFPB Auto Finance Forum* (Nov. 14, 2013) ("When consumers sit down at the table to discuss their prospects for a loan, they are often unaware of the options actually available to them and are unaware of lender incentives, not effectively disclosed, for intermediaries to provide higher rates than they actually qualify for.").
[58] Consumer Financial Protection Bureau, *CFPB Bulletin 2013-02: Indirect Auto Lending and Compliance with the Equal Credit Opportunity Act* [hereinafter *CFPB Bulletin 2013-02*] 1 (Mar. 21, 2013), http://files.consumerfinance.gov/f/201303_cfpb_march_-Auto-Finance-Bulletin.pdf.
[59] November 19, 2014, Decision Memorandum, "Authorization to Seek a Settlement or Commence Litigation," 27.
[60] Consumer Financial Protection Bureau, *CFPB Bulletin 2013-02* at 1–2.
[61] *Id.* at 2.
[62] April 3, 2013, Briefing Memorandum, "Auto Finance Discrimination Initiative Update Meeting," 4.

The Bureau's Application of ECOA to Indirect Auto Lending

Notwithstanding the lack of clear statutory authority or evidence of Congressional intent to support its claim that disparate impact is cognizable under ECOA, the Bureau has pursued an aggressive ECOA enforcement agenda. On March 21, 2013, the Bureau published another bulletin entitled "Indirect Auto Lending and Compliance with the Equal Credit Opportunity Act."[63] The bulletin asserted that indirect auto creditors are "likely" considered creditors subject to ECOA, and that their failure to impose adequate controls on dealer compensation policies or eliminate dealer discretion to charge car buyers retail interest rates could subject them to disparate impact liability.[64]

To be considered a "creditor" subject to ECOA, auto finance companies must participate in an auto dealer's decision to extend consumer financing in connection with an automobile purchase.[65] In an internal decision memorandum approved by Director Cordray, Assistant Director Ficklin acknowledged that these companies are likely to argue that they are not creditors as defined by ECOA and Regulation B but merely potential assignees that play no role in deciding the amount of the dealer reserve. In dismissing this argument, Ficklin asserted that:

> "their practice of evaluating an applicant's information, establishing a buy rate specific to that applicant, communicating that buy rate to the dealer, and indicating that they will purchase the obligation at the designated buy rate plus an articulated range of dealer markup if the transaction is consummated, very likely make them creditors under ECOA."[66]

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[63] *See generally id.*
[64] *Id.* at 1–2.
[65] *See* 15 U.S.C. § 1691a(e). The Bureau's Commentary to Regulation B provides that a "creditor" "includes all persons participating in the credit decision" and that "[t]his may include an assignee or a potential purchaser of the obligation who influences the credit decision by indicating whether or not it will purchase the obligation if the transaction is consummated." *See* 12 C.F.R. Part 1002, Supp. I, § 1002.2, ¶ 2(*l*)-1.
[66] November 19, 2014, Decision Memorandum, "Authorization to Seek a Settlement or Commence Litigation," 20.

However, what Ficklin did not share with Director Cordray is that in a material percentage of transactions a dealer will enter into a RISC with a buyer *without first receiving responses from indirect auto creditors*.[67] Such transactions are known as "spot deliveries." In such circumstances, it is far from clear that the creditor participated in the dealer's decision to extend credit to the buyer, and thus would be defined as a "creditor" subject to ECOA. Creditors have been explaining this issue to the Bureau since at least September 24, 2012, when one creditor submitted a "white paper" to the Bureau that contained this description:

> To be deemed a creditor as an assignee of an auto dealer regarding any particular retail installment contract, [Institution A] would have to participate in or influence that dealer's credit decision or pricing of the contract. In fact, the dealer is entirely free to negotiate the price of financing with its customer (along with vehicle price, trade-in value, dealer-installed options, and "add-on" products such as such as extended warranties) before shopping the contract to [Institution A] and other purchasers of retail installment contracts. By the time that [Institution A] communicates to a dealer its buy rate for a particular transaction, the transaction may have already been negotiated with the customer. Even where [Institution A] communicates its buy rate to the dealer before the transaction has been negotiated, it is typically one of multiple potential purchasers communicating with the dealer, making it impossible to determine those instances, if any, in which [Institution A]'s response was the one that influenced the negotiations between the dealer and its customer.[68]

The Bureau apparently does not address this issue in its fair lending analysis. Though it might be inconvenient for the Bureau to ascertain whether each finance company participated in each dealer's decision to extend credit on a case-by-case basis, it is vitally

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[67] *See e.g.* ARTHUR P. BAINES AND DR. MARSHA J. COURCHANE, FAIR LENDING: IMPLICATIONS FOR THE INDIRECT AUTO FINANCE MARKET 33 (November 19, 2014) (Charles River Associates (CRA) Report for Prepared for American Financial Services Association (AFSA)) (hereinafter, the "CRA/AFSA Report"), *available at* http://www.crai.com/sites/default/files/publications/Fair-Lending-Implications-for-the-Indirect-Auto-Finance-Market.pdf.

[68] September 24, 2012, Institution A White Paper, "Regarding Indirect Auto Finance Liability Under the Equal Credit Opportunity Act," 2 (included in February 14, 2014 CFPB Referral of Institution A Matter to DOJ). Institution names appearing in direct quotes have been redacted unless the institution has entered into a public consent order with the Bureau.

important that it do so, since the application of ECOA itself rests upon whether or not the company meets the statutory definition of a "creditor."

The Bureau's Case Against Indirect Auto Lenders

Assuming, *arguendo*, that ECOA permits disparate impact claims, and that finance companies are always creditors subject to ECOA, the Bureau must still prove that the company is liable for discrimination on a prohibited basis. To establish a *prima facie* case for a disparate impact claim under ECOA, the Bureau must: (1) identify a specific policy or practice adopted by a creditor; (2) demonstrate a disparate impact on a prohibited basis; and (3) show a causal relationship between the challenged practice and the alleged disparate impact.[69] Documents obtained by the Committee show that the Bureau will likely have difficulty proving any one of these requirements, much less all three. Perhaps as a consequence, the Bureau has settled or administratively disposed of each disparate impact auto financing case it has brought against an indirect creditor to date.

Proving Adoption of a Specific Policy or Practice

To establish a *prima facie* case of disparate impact under ECOA, the Bureau must identify a specific policy or practice adopted by an indirect auto creditor. As an initial matter, "dealer discretion" is not a "practice" under current law or any common sense definition of the word. In ECOA matters, the term "discretion" is traditionally used in the context of policies that allow loan officers to deviate from their own bank's automated underwriting process. As already discussed, consumer advocates, plaintiffs' lawyers, and the Bureau have framed the difference between the discounted wholesale interest rates offered dealers and the retail rates offered buyers in terms of "dealer discretion" – i.e.

[69] *Smith v. City of Jackson*, 544 U.S. 228, 241 (2005).

"allowing" dealers to negotiate interest rates with their customers. The analogy is clearly inapt – finance companies cannot give dealers "discretion" to deviate from interest rates the dealers were never obligated to use in the first place.

Internal Bureau memoranda reveal that Assistant Director Ficklin and other Office of Fair Lending attorneys understood and advised Director Cordray on the weakness of their legal theory. The Office of Fair Lending's November 19, 2014, memorandum informed Director Cordray that in 2011, the Supreme Court, in *Wal-Mart Stores, Inc. v. Dukes*, had ruled that Wal-Mart's policy of allowing discretion by local supervisors over employment matters was not a specific practice that "could be challenged under the disparate impact theory."[70] In *Dukes*, the Court stated that Wal-Mart's

> "'policy' of *allowing discretion* . . . is just the opposite of a uniform employment practice . . . it is a policy against having uniform employment practices. It is also a very common and presumptively reasonable way of doing business – one that we have said 'should itself raise no inference of discriminatory conduct.'"[71]

The Office of Fair Lending's legal analysis conceded that it would be difficult to distinguish the policy/practice of allowing dealer "discretion" over car buyers' RISC interest rates from Wal-Mart's policy/practice of allowing local managers discretion over employee pay and promotions, and that:

> "[Finance companies' potential arguments are] supported in part by several decisions that have, almost uniformly, held that wholesale lender liability under the disparate impact doctrine for allowing broker discretion does not meet the commonality requirement for class certification. While these decisions were made in the class certification context, they nonetheless mirror language in *Dukes* that a discretionary policy is not specific enough to support a disparate impact claim."[72]

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[70] November 19, 2014, Decision Memorandum, "Authorization to Seek a Settlement or Commence Litigation," 23 (citing *Wal-Mart Stores*, *Inc. v. Dukes*, 131 S. Ct. 2541 (2011)).
[71] 131 S. Ct. 2541, 2554 (2011) (quoting *Watson v. Fort Worth Bank & Trust*, 487 U.S. 977, 990 (1988)).
[72] November 19, 2014, Decision Memorandum, "Authorization to Seek a Settlement or Commence Litigation," 26.

And:

> "There is little applicable case law regarding a government enforcement action on facts similar to *Dukes* since that decision, and while there are bases to distinguish *Dukes*, plaintiffs have consistently been unable to obtain class certification in cases challenging discretionary broker pricing, which are quite analogous to this matter."[73]

In fact, the finance companies' argument that dealer discretion is not a "practice" is stronger than Wal-Mart's winning argument. In *Dukes*, Wal-Mart's local managers are Wal-Mart employees bound by Wal-Mart policies that Wal-Mart has a meaningful ability to enforce.[74] In the auto finance context, however, car dealers are completely independent of auto finance companies, and finance companies have almost no practical ability to accurately test dealers for disparate impact.

Proving Disparate Impact on a Prohibited Basis

ECOA and Regulation B generally prohibit a creditor from inquiring "about the race, color, religion, national origin, or sex of an applicant or any other person in connection with a credit transaction"[75] Thus, dealers do not request this information from car buyers applying for financing, and this information is not transmitted to indirect auto creditors. However, to establish a *prima facie* case for a disparate impact claim under ECOA, the Bureau must demonstrate that a disparate impact on a prohibited basis occurred. As a result, the Bureau has elected to use substitute, or "proxy," information submitted by car buyers on credit applications to derive their demographic characteristics.[76]

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[73] *Id*. at 45.
[74] *Dukes*, 131 S. Ct. at 2563.
[75] 12 C.F.R. § 1002.5(b) (2015).
[76] *See generally* CFPB, Using Publicly Available Information to Proxy for Unidentified Race and Ethnicity: A Methodology and Assessment (Summer 2014) (hereinafter "CFPB White Paper"), *available at*, http://files.consumerfinance.gov/f/201409_cfpb_report_proxy-methodology.pdf.

In conducting its fair lending analysis, the Bureau's Office of Fair Lending hired an outside contractor, BLDS, LLC, to adapt a statistical proxy method originally developed for health outcome research.[77] This proxy method, known as the "Bayesian Improved Surname Geocoding" (BISG) proxy method, combines surname- and geography-based information into a single proxy probability for race and ethnicity.[78]

Despite receiving letters from scores of Members of Congress requesting details about the Bureau's proxy methodology,[79] Director Cordray did not initially reveal the

[77] BISG was initially developed as part of a largely academic effort to measure racial disparities in population-wide health care outcomes, not for disparate impact enforcement. *See* Marc N. Elliott et al., *Using the Census Bureau's Surname List to Improve Estimates of Race/Ethnicity and Associated Disparities*, HEALTH SERVS. & OUTCOMES RES. METHODOLOGY 9:69-83 (2009), *available at* http://www ncbi.nlm.nih.gov/pmc/articles/PMC2653886/. The Bureau's Office of Research (OR) then adapted BISG for calculating disparities. *See e.g.* July 23, 2012, Draft, "Race-Proxy Method-Two applicants," 3 ("Surname and local demographic probabilities are combined by Bayesian updating to generate our authoritative set of probabilities. The method is described in Elliott et al., "Census Data for Proxies," Health Serv Outcomes Res Method (2009)."). The Bureau's model's core assumption is that any disparities are caused by disparate treatment, yet the Bureau uses the model for disparate impact cases alleging no disparate treatment. *See* April 2013 Draft Memorandum, "Choice of Estimation Methods for Indirect Auto Lending Markup Disparities," Draft 2, 1 ("The OR Method assumes that members of different classes experience different markup outcomes because auto dealers on average treat them differently on the basis of their class membership—in other words, markup disparities are caused by disparate treatment." (emphasis in original)); *see also* Comparison of Siskin methodology and CFPB Initial Methodology.

[78] *See generally* CFPB White Paper, *available at,* http://files.consumerfinance.gov/f/201409_cfpb_report_proxy-methodology.pdf.

[79] *See* Letter from the Hon. Terri Sewell et. al., Members of the House of Representatives, to Richard Cordray, Director of the Consumer Financial Protection Bureau (May 28, 2013) (Rep. Sewell and 12 Members of the House, requesting "any and all background information about the origination of an investigation into alleged practices within the auto industry . . . [including] the method the Bureau is using to identify different groups of consumers, the factors it is holding constant to ensure its findings of price differentials are attributable to a consumer's background, and the numerical threshold at which the Bureau determines that disparate impact is present."); Letter from the Hon. Spencer Bachus et al., Members of the House of Representatives, to Patrice Ficklin, Assistant Director of Fair Lending, Bureau of Consumer Financial Protection (Jun. 20, 2013) (Rep. Bachus and 34 Members of the House, including 27 Members of the Committee, requesting "the full set of details concerning [the Bureau's] statistical impact methodology, including (i) the proxies used to determine the background of consumer credit applicants; (ii) the factors held constant to isolate the· applicant's background as the sole reason for any alleged pricing disparity; (iii) the metric used to measure whether pricing disparities exist (e.g., basis points, the dollar amount of the finance charge, etc.); (iv) the numerical threshold at which it was determined that a pricing disparity on a prohibited basis constitutes an [Equal Credit Opportunity Act) violation . . . [and] all studies, analysis, and information [the Bureau] relied upon in developing its [March 21, 2013, indirect auto lending] guidance."); Letter from Spencer Bachus, Member of the House of Representatives, to Richard Cordray, Director of the Consumer Financial Protection Bureau (September 24, 2013) (requesting information about Bulletin 2013-02 including the "data and assumptions the CFPB relied on to substantiate . . . that there is a problem with fair lending in the indirect auto finance market . . . . [and] [t]he detailed methodology that measures whether discrimination is present in an auto creditor's portfolio."); Letter from the Hon. Rob Portman et. al., United States Senators, to Richard Cordray, Director of the Consumer Financial Protection Bureau, (Oct. 30, 2013) (Sen. Portman and 21 Senators, requesting complete details concerning

mathematical formulas, computer code, and other information required to understand the methodology and to test its accuracy. Internal Bureau memoranda drafted by Assistant Director Ficklin and edited by senior Office of Fair Lending attorneys reveal that the Office of Fair Lending first planned to recommend concealing this information,[80] but in later drafts ultimately advised disclosure after conferring with the Department of Justice (DOJ).[81]

On September 17, 2014, in response to Congressional pressure, the Bureau finally published a White Paper disclosing some aspects of its proxy methodology and assessing

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the statistical methodology the Bureau employs to determine whether disparate impact is present in an auto creditor's portfolio."); Letter from Hon. Colleen Hanabusa, Member of the House of Representatives, to Richard Cordray, Director of the Consumer Financial Protection Bureau, (Oct. 29, 2013) (requesting a more detailed methodology used to determine disparate impact); Letter from the Hon. Max Baucus, United States Senator, to Richard Cordray, Director of the Consumer Financial Protection Bureau (Nov. 12, 2013) (expressing concern with the Bureau's auto-lending guidance, CFPB Bulletin 2013-02); Letter from Hon. Blaine Luetkemeyer, Member of the House of Representatives, to Richard Cordray, Director of the Consumer Financial Protection Bureau (Nov. 15, 2013) (expressing concern with the compliance steps outlined in the Bureau's auto-lending guidance, CFPB Bulletin 2013-02); Letter from the Hon. Jeffrey A. Merkley, United States Senator, to Richard Cordray, Director of the Consumer Financial Protection Bureau (Nov. 19, 2013) (expressing concern that the Bureau's auto-lending guidance, CFPB Bulletin 2013-02, could lead to substituting a flat-fee dealer compensation model for dealer reserve, and pointing out that such a model is against buyers' best interests); Letter from Hon. Alcee L. Hastings, et al., Members of the House of Representatives, to Richard Cordray, Director of the Consumer Financial Protection Bureau (Dec. 18, 2013) (Rep. Hastings and 15 Members of the House, expressing concern with the Bureau's auto-lending guidance, CFPB Bulletin 2013-02, and requesting the Bureau respond to unanswered prior "Congressional requests for the raw data and specific methodology used to determine instances of 'disparate impact' and formulate the new guidance."); Letter from Hon. Spencer Bachus, Member of the House of Representatives, to Richard Cordray, Director of the Consumer Financial Protection Bureau (Apr. 1, 2014) (requesting that "[o]ther than a potential flat fee or a variation of it, please provide at least one example of a specific discretionary dealer compensation mechanism lenders can adopt that is consistent with your March 2013 guidance to indirect finance sources."). Indeed, even after the Bureau eventually published its white paper on its BISG methodology, in 2014, it failed to fully disclose information needed to understand the Bureau's disparity calculations fully, and Members of Congress have continued to request the needed information from the Bureau, to no avail. *See e.g.* Letter from Hon. Ben Ray Lujan, Member of the House of Representatives, to Richard Cordray, Director of the Consumer Financial Protection Bureau (Jan. 20, 2015) (expressing concern with the Bureau's auto-lending guidance, CFPB Bulletin 2013-02, and requesting information about the "authority, scope, and what legally binding restrictions this guidance puts into force on the indirect lending model."); Letter from the Hon. Jeb Hensarling, Chairman of the House Financial Services Committee, to Richard Corday, Director of the Consumer Financial Protection Bureau (May 7, 2015) (requesting information about the Ally settlement disbursement); Letter from the Hon. Jeb Hensarling, Chairman of the House Financial Services Committee, to Richard Corday, Director of the Consumer Financial Protection Bureau (Aug. 5, 2015) (requesting information about the Ally settlement disbursement).

[80] *See* May XX, 2013, Decision Memorandum, "Potential Methodological Announcements," Draft, 1.

[81] June XX, 2013, Decision Memorandum, "Potential methodological announcements: proxy methodology and disparity tolerances," Draft 2, 5, 8 ("We have conferred with DOJ, however, and they support a public announcement of our methodology for purposes of informing the industry of the approach we use in the supervisory context and that industry can apply in its own compliance management.").

BISG's accuracy relative to two other proxies.[82] To construct its proxy, the Bureau first calculates an applicant's probability of belonging to a specific race and ethnicity by comparing the applicant's last name with data derived from the U.S. Census Bureau that breaks down the percentage of individuals with that name belonging to one of six racial and ethnic categories.[83] For example, "according to the census surname list, 73% of individuals with the surname Smith report being non-Hispanic White; thus, for any individual with the last name Smith, the surname-based probability of being non-Hispanic White is 73%."[84] The Bureau next calculates an applicant's probability of belonging to a specific race and ethnicity by comparing the applicant's address with other Census Bureau data that identifies the racial composition of a particular geographic unit, whether census block group, census tract, or 5-digit zip code.[85] For example, if an applicant lives in a census block that is 50% white, 25% black, 20% Hispanic, and 5% Asian, the borrower will be assigned a 50% probability of being white, 25% probability of being black, 20% probability of being Hispanic, and 5% probability of being Asian. The Bureau then uses Bayes' Theorem to update the applicant's surname probabilities with his or her address probabilities to arrive at composite probabilities.[86]

As it turns out, the Bureau had good reason not to release the details of its application of BISG – the Office of Fair Lending had chosen it over other proxy

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[82] *See generally* CFPB White Paper, *available at*, http://files.consumerfinance.gov/f/201409_cfpb_report_proxy-methodology.pdf.
[83] *Id.* at 7.
[84] *Id.* at 9.
[85] *Id.* at 7-10.
[86] *Id.* at 10. The Wall Street Journal recently published an article and accompanying application that can calculate these probabilities. *See* AnnaMaria Andriotis and Rachel Louise Ensign, *U.S. Government Uses Race Test for $80 Million in Payments* WALL ST. J. (updated Oct. 29, 2015), *available at* http://www.wsj.com/articles/u-s-uses-race-test-to-decide-who-to-pay-in-ally-auto-loan-pact-1446111002, race calculator *available at* http://graphics.wsj.com/ally-settlement-race-calculator/.

methodologies that had been proven more reliable. In early drafts of a decision memorandum for the Director contemplating whether or not to release its proxy methodology publicly, Assistant Director Ficklin and other Office of Fair Lending staff admit:

> "[W]e have *reason to believe that our proxy [methodology] is less accurate* in identifying the race/ethnicity of particular individuals than some proprietary proxy methods that use nonpublic data."[87]
>
> And:
>
> "*These proprietary methods are likely to achieve a greater level of accuracy* in identifying the race/ethnicity of particular individuals *but we have chosen not to use them* because our use of any nonpublic data compromises our ability to encourage improvement of compliance management in the nonmortgage lending industry."[88]

The draft memorandum also describes the "serious risk" that a "methods announcement" would "provid[e] fodder to defendants to *show how our methods are inferior to other proprietary proxies*," and "[i]f we choose not to publish, *we will be more likely to consult an outside expert for litigation purposes and our internal methodological deliberations will not be discoverable*."[89]

Assistant Director Ficklin and the Bureau may have justified the decision not to use these more accurate proxies by arguing that companies could save money by not having to acquire proprietary products and instead rely upon publicly available information.[90] The

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[87] May XX, 2013, Draft Decision Memorandum, "Potential Methodological Announcements," at 6 (emphasis added); June XX, 2013, Draft Decision Memorandum, "Potential methodological announcements: proxy methodology and disparity tolerances," Draft 1, 5 (emphasis added).
[88] May XX, 2013, Draft Decision Memorandum, "Potential Methodological Announcements," 4 (emphasis added); June XX, 2013, Draft Decision Memorandum, "Potential methodological announcements: proxy methodology and disparity tolerances," Draft 1, 5 (emphasis added).
[89] May XX, 2013, Draft Decision Memorandum, "Potential Methodological Announcements," at 6 (emphasis added); June XX, 2013, Draft Decision Memorandum, "Potential methodological announcements: proxy methodology and disparity tolerances," Draft 1, 5 (emphasis added).
[90] *Cf.* June 4, 2013, Presentation, "Proxy Methodology Discussion," 2-3.

Bureau's concern in this instance about the regulatory costs it was imposing on creditors is admirable; however, it is undoubtedly cold comfort to creditors publicly labeled as engaging in racial discrimination in enforcement actions brought by the Bureau using a methodology it knew to be faulty and unreliable.

Assistant Director Ficklin and her Office were also concerned that publishing the Bureau's proxy methodology and allowing review by unbiased statisticians could result in public ridicule, bipartisan scrutiny from Congress, and inquiries into other questionable Bureau statistical practices:

> "Finally, publicizing our methodology in the short term opens our methodology up to attack and further questions. News reports are already labeling it as *racial profiling and junk science*, and these aspersions may increase if we reveal greater specificity (although those attacks may also continue regardless) . . . Also, we recently received a letter from several Democrats on the House Financial Services Committee asking for details on our methods, and would expect further requests (and perhaps even a Congressional hearing) to explain any announcements about methodology. Moreover, the more detail we provide, the more questions we may receive about more complicated subjects such as our regression modeling."[91]

Additionally, in a preliminary draft of the White Paper, Brian Kreiswirth, a Deputy Assistant Director in the Office of Fair Lending, stated: "We should consider anticipating the argument that the proxy is only 70% accurate for African Americans."[92]

As Assistant Director Ficklin feared, once the Bureau released its White Paper, statisticians quickly demonstrated just how flawed the Bureau's proxy methodology was. On November 19, 2014, Charles River Associates (CRA), on behalf of the American

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[91] June XX, 2013, Draft Decision Memorandum, "Potential methodological announcements: proxy methodology and disparity tolerances," Draft 1, 6 (emphasis added); *see also* May XX, 2013, Draft Decision Memorandum, "Potential Methodological Announcements," at 7.

[92] CFPB, Draft White Paper, "Using Publicly Available Information to Proxy for Unidentified Race and Ethnicity: A Methodology and Assessment," Draft 1, 15; CFPB, Draft White Paper, "Using Publicly Available Information to Proxy for Unidentified Race and Ethnicity: A Methodology and Assessment," Draft 2, 15.

Financial Services Association (AFSA), published an analysis of the White Paper and the Bureau's methodology.[93] The CRA report concluded that the Bureau's methodology and others like it are "conceptually flawed in their application and *subject to significant bias and estimation error*."[94] The CRA report also found that "The BISG methodology estimates that 11% of the applicant pool is African American, while the actual share is only 7.8%. This is a 41% overestimation of the African American share of the pool."[95] Most importantly, the report noted that Table 10 of the Bureau's own White Paper reported similar flaws, including a 20% overestimation of African Americans.[96]

The CRA report also explained many of the reasons for the Bureau's inability to accurately predict the race and ethnicity of borrowers. Some flaws were striking, such as outdated (now 15 year-old) census data and the limited value of surname information.[97] Other errors were less conspicuous but more serious. The first was that in most cases, using the raw percentage of minority populations as a proxy for minority borrowers results in significant overestimates of minority borrowers because Hispanics, African Americans, and Asians have considerably lower per capita rates of car ownership than whites.[98] For example, 19.0% of black households own no vehicle, compared to 6.8% of white households.[99] Furthermore, white households finance a much higher percentage of their

[93] CRA/AFSA Report, *available at* http://www.crai.com/sites/default/files/publications/Fair-Lending-Implications-for-the-Indirect-Auto-Finance-Market.pdf. Interestingly, the Bureau contracted with CRA in 2014 to perform diversity compliance support services within the Bureau. *See*, e.g., Fiscal Year 2014 Service Contract Inventory Worksheet, available at http://files.consumerfinance.gov/f/201505_cfpb_summary_service-contract-inventory-fiscal-year-2014-appendix-b.pdf.
[94] *Id.* at 6 (emphasis added).
[95] *Id.* at 58.
[96] *Id.* at 58 ("The Bureau's results, as reported in their White Paper, are consistent with our results, although they found a larger overestimation for Hispanic and Asian consumers, while we found larger overestimation for African American consumers.")
[97] *Id.* at 48.
[98] *See id.* at 49.
[99] *Id.* at 49.

vehicle purchases than minority households, especially African-American households.[100] Any methodology such as the Bureau's that ignores these facts will have increased estimation errors that will overstate the number of minority individuals financing automobiles.

Internal documents reveal that the Bureau ignored strong evidence that its methodology produced worse results than indicated publicly in its White Paper. In a November 19, 2014, decision memorandum recommending enforcement action against three institutions, the Office of Fair Lending reported that some outside the Bureau had used BISG to estimate the race and ethnicity of borrowers whose correct race and ethnicity was known through Home Mortgage Disclosure Act (HMDA) data.[101] Assistant Director Ficklin informed Director Cordray:

> "[Some outside the Bureau] reported that the proxy methodology very poorly identified Hispanics and African Americans in the HMDA data . . . . For example, one lender reported based on its analysis of its own HMDA data that the proxy methodology was only able to identify 56.9% of the Hispanic and 18.9% of the African American applications in the HMDA data (*i.e.,* false negative); in other words, *for every one hundred African-American applicants in the HMDA data, the proxy methodology could only identify roughly 19 of them as African-Americans.* Moreover, only 54% of the applicants identified by the proxy methodology as African-American were actually African-American and 66.5% of the applications identified by the proxy methodology as Hispanic were actually Hispanic (i.e., false positive); in other words *out of 100 applicants that are identified by the proxy methodology as African-Americans, only 54 of them are actually African-Americans according to the HMDA data*."[102]

A draft of the Bureau's talking points rebutting the CRA report reveals the Bureau's disingenuous argument that minorities are underrepresented in HMDA data because they

[100] *Id.* at 49-50.
[101] November 19, 2014, Decision Memorandum, "Authorization to Seek a Settlement or Commence Litigation," 32. Unlike for automobile credit applications, HMDA permits collection of such data for mortgages.
[102] *Id.* at 32, 32 n.2 (emphasis added).

take out proportionately fewer mortgages, making HMDA data an inappropriate test of BISG's accuracy:

> "[W]hile for the set of mortgage applications under review, the proxy tended to overestimate the number of minority borrowers, particularly African Americans, mortgage applications are not representative of the general population and that may account for the overestimation. When the proxy is applied to data (e.g., non-mortgage products) where the applicants are more representative of the general population there may not be overestimation or it may be much less."[103]

However, the Bureau used similar analysis in its White Paper to assert BISG's superiority to other proxy methodologies *as measured against HMDA data*.[104] And Assistant Director Ficklin acknowledged the hypocrisy of the Bureau's position in a preliminary draft of the White Paper:

> "[W]e are making two points that may appear to be contradictory. On the one hand, we are treating proximity to HMDA reported figures as a measure of accuracy, while on the other hand we are saying that the gap may reflect the fact that the HMDA distribution doesn't match the overall Census distribution. Considering both points could cause one to question whether its's a good thing for Census-based measure to come closer to the HMDA reported measure (e.g., the close % for Hispanics) . . . . perhaps we should just focus on the first point."[105]

And while the Bureau asserts that a higher percentage of minorities finance automobiles than finance homes, the Bureau has never produced statistics on minority auto financing rates. While car dealers do not keep such statistics, other organizations do, and the Bureau could conceivably obtain them. Moreover, as the CRA report notes, the two major publicly available surveys on the subject reveal that the rate of minorities financing

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[103] Draft Indirect Auto Lending: Talking Points on Proxy Methodology and AFSA Policy Paper, 1.

[104] *See* CFPB White Paper at 12-14, *available at*, http://files.consumerfinance.gov/f/201409_cfpb_report_proxy-methodology.pdf.

[105] CFPB, Draft White Paper, "Using Publicly Available Information to Proxy for Unidentified Race and Ethnicity: A Methodology and Assessment," Draft 2, 13; *see also* "Q&A Document," (attempting to rebut the CRA/AFSA Report's proof – using the HMDA – that the Bureau's estimation method overestimates minorities with the weak defense: "*we do not know if* the proxy overestimates minorities when it is applied to the auto market." (emphasis added)).

autos is low relative to the percentage of minorities in the general population: the American Community Survey (ACS) and the Consumer Expenditure Survey (CEX) reveal that "African American and Hispanic households appear to finance new vehicles at lower rates than their population shares would suggest . . . . [and] [t]aken together, the ACS and CEX data suggest that minority groups do not purchase or finance vehicles in proportion to their shares of the overall population."[106] The Bureau's proxy methodology should take this information into account.

Another flaw in the Bureau's methodology is that it presumes that the majority of auto purchasers live in racially segregated geographical areas. However, Institution A submitted data to the Bureau rebutting this presumption as early as January 17, 2013:

> "This approach, however, overstates any disparities because for [Institution A], like many other lenders, the majority of our protected class customers reside in census tracks that are <u>majority White</u>. As a consequence, a more accurate picture of any African-American (or Hispanic or Asian) effect on dealer markup can be obtained through a proportional weighting methodology, rather than one that places heavy emphasis on the extreme ends of the distribution. Put another way, because only a small percentage of protected class customers live in areas that are heavily minority, the over-emphasis on such areas leads to distorted results.
>
> Although the fact that a majority of protected class customers reside in areas that are predominately white may seem counterintuitive, it is clear from an analysis of the data that this is the case . . . . *[A]pproximately 72% of [Institution A]'s African-American customers reside in census tracts that are less than 50% African-American.* Moreover . . . *a typical [Institution A] African-American customer is four times more likely to reside in a census tract that is 90% white than a tract that is 90% African-American.* As a consequence we believe that our proportional weighting methodology provides a more accurate estimate of the result that would be obtained with actual race and ethnicity data then does the Bureau's preliminary method."[107]

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[106] CRA/AFSA Report, at 49, 50–51 ("The ACS reports 11.2%, 19.0% and 10.2% of Hispanic, African American and Asian households, respectively, did not own a vehicle during 2012, as compared to 6.8% of non-Hispanic white households.").

[107] January 17, 2013, Institution A Parr/NORA Response Letter to CFPB Counsel Shou Wang, 10-11 (included in February 14, 2014 CFPB Referral of Institution A Matter to DOJ) (underlined emphasis in original, all other emphasis added).

This data demonstrates that any disparity estimate generated by the BISG method is likely inaccurate as applied to Institution A and any similarly situated institution.

Internal documents reveal that the Bureau has been unable to identify actual discriminatory practices (disparate treatment) by individual car dealers. For example, in a draft of the decision memorandum regarding Ally Financial (Ally), one of the indirect auto creditors targeted by the Bureau, enforcement attorneys did not consider pursuing a disparate treatment claim other than to acknowledge that "[w]hile disparate treatment may be a possible method . . . the strongest case to prove Ally's violation of the ECOA can be made under disparate impact theory."[108] The memorandum later reported:

> "Ally's analysis resulted in the identification [of] 21 dealers out of approximately 12,000 for possible markup disparities and conducted a match pair review analysis for each of the 21 dealers . . . . Based upon the matched pair review, two low-volume dealers were identified as having possible markup disparities and Ally imposed the first tier corrective action of voluntary education."[109]

Assistant Director Ficklin's comment (attributable by her initials) on these facts speaks for itself: "It's not clear whether we view this as good or bad, and it doesn't add much to the discussion. I'd suggest deleting."[110]

Proving a Causal Relationship

To establish a *prima facie* case for a disparate impact claim under ECOA, the Bureau must show a causal relationship between the challenged practice and the alleged disparate impact. In *Inclusive Communities*, the Supreme Court reemphasized the bedrock principle

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[108] October 7, 2013, Draft Decision Memorandum, "Authorization to Seek a Settlement with Ally Financial, Inc. and Ally Bank and to File Complaint and Resolution in Federal District Court or to File a Resolution Administratively," 5.

[109] *Id.* at 7.

[110] *Id.* at 7.

that the mere existence of statistical disparities without a policy that actually *causes* those disparities does not give rise to liability under the disparate impact theory:

> "[A] disparate-impact claim that relies on a statistical disparity must fail if the plaintiff cannot point to a defendant's policy or policies causing that disparity. A robust causality requirement ensures that '[r]acial imbalance . . . does not, without more, establish a prima facie case of disparate impact' and thus protects defendants from being held liable for racial disparities they did not create."[111]

Implicit in this requirement is that to be certain that a creditor's policy *is* causing an observed racial disparity, a fair and robust causality analysis should also confirm that other explanatory factors *are not* causing the disparity. In the auto finance context, several non-discriminatory factors could account for racial disparities observed when examining dealer reserve. These factors include a borrower's creditworthiness, the characteristics of the vehicle, the timing, location, and structure of the deal, the composition of a creditor's portfolio, customer monthly payment constraints, competing dealer or credit offers, promotional financing or incentive campaigns, and inventory reduction considerations.[112]

For instance, racial disparities within a creditor's portfolio can be caused by the composition of the portfolio itself. Consider the following simplified example:

- Dealer 1 and Dealer 2 each sell identical cars to 100 customers with dealer financing, and all 200 customers pay the exact same overall price;
- Dealer 1's customers are 80% Hispanic and 20% white;
- Dealer 2's customers are 80% white and 20% Hispanic;
- Dealer 1 sells cars below invoice and charges a dealer reserve of 250 basis points;
- Dealer 2 sells cars at invoice but charges no dealer reserve;
- If an auto finance company buys all of both dealers' RISCs, its portfolio will consist of:
    - 80 finance contracts to Hispanic borrowers with a 250 basis point dealer reserve;

[111] *Inclusive Communities*, 135 S. Ct. at 2523 (alteration in original) (citing *Wards Cove Packing Co. v. Atonio*, 490 U.S. 642, 653, 109 S.Ct. 2115, 104 L.Ed.2d 733 (1989)).
[112] Even the Department of Justice has acknowledged these legitimate factors as allowing for different dealer participation rates among consumers. See, e.g., Consent Order, *United States v. Pacifico Ford, Inc.*, Appendix B, available at http://www.justice.gov/sites/default/files/crt/legacy/2010/12/15/pacifico_order.pdf.

- 20 finance contracts to Hispanic borrowers a 0 basis point dealer reserve;
- 20 finance contracts to white borrowers with a 250 basis point dealer reserve; and
- 80 finance contracts to white borrowers marked with a 0 basis point dealer reserve.

In this example, the average dealer reserve for Hispanic borrowers in the finance company's portfolio will be 200 basis points, and the average dealer reserve for white borrowers in the finance company's portfolio will be 50 basis points. Despite the fact that each dealer treated all of its customers identically – whether Hispanic or white – and every customer paid the same overall amount for identical cars, the Bureau would conclude that Hispanic borrowers in the finance company's portfolio paid an average 150 basis points more than white borrowers in the portfolio (a huge disparity), and therefore the finance company's "practice" of allowing dealers to negotiate retail interest rates had a harmful disparate impact on Hispanic consumers. In conducting its fair lending analysis, the Bureau examines a creditor's entire portfolio rather than on a dealer-by-dealer basis. Because the Bureau apparently does not correct or control for portfolio composition in its analysis, it cannot be certain that this factor, rather than a creditor's discretionary dealer reserve "policy," is causing the disparities it observes. And, it should be noted, the Bureau only focuses on one isolated element of a larger transaction (dealer participation), when the total amount paid by a car buyer includes both dealer participation and price of the car. Analysis of the whole transaction may yield much different results that are not reflected in the Bureau's analysis.

Other race-neutral factors such as creditworthiness can result in racial disparities within a creditor's portfolio. In a competitive auto finance market, finance companies have different business models that focus on different market segments and different types of finance contracts with certain risk factors, much like some people invest in blue chip stocks while others invest in technology stocks. Consequently, creditors rarely, if ever, acquire a representative cross-section of any dealer's RISCs. If a finance company offers dealers better deals (lower interest rates) than its competitors for the RISCs of borrowers with credit scores between 650 and 700, dealers are likely to sell (assign) their 650-700 rated RISCs to that company; for the same reason, dealers will be inclined to sell their 700-800 rated RISCs to another finance company that offers better deals on 700-800 rated RISCs. The composition of each creditor's portfolio thus varies based on its preferences – portfolios may contain greater or fewer finance contracts with certain race-neutral characteristics (e.g., 650-700 rated borrowers, low income borrowers, borrowers in different parts of the county, used car buyers, high down payments, etc.). Some of these race-neutral characteristics are more prevalent in minority borrowers. According to a 2007 study by the Federal Reserve, credit scores are lower on average for African-Americans and Hispanics than non-Hispanic whites and Asian-Americans.[113] Other publicly available data shared with the Bureau by one creditor confirm a correlation between a borrower's credit tier and the dealer reserve applied to that borrower:

INDUSTRYWIDE April 2011 – March 2012 Credit Score	INDUSTRYWIDE April 2011 – March 2012 Average Rate Spread
800-999	0.56%

[113] FED. RESERVE BD., REPORT TO THE CONGRESS ON CREDIT SCORING AND ITS EFFECTS ON THE AVAILABILITY AND AFFORDABILITY OF CREDIT, (Aug. 2007) *available at* http://www.federalreserve.gov/boarddocs/rptcongress/creditscore/executivesummary.htm.

740-799	0.58%
700-799 680-699	0.71% 0.80%
660-679 640-659	0.87% 0.91%
620-639 600-619	0.96% 1.01%
Source: J.D. Power, Power Information Network Data, Experian ScoreEx Plus data	

To understand why this relationship exists, consider that dealers may have to work harder to place credit-challenged customers (i.e., satisfy more stipulations), and a higher margin on such deals reflects a greater cost overlap. In addition, credit-challenged customers tend to finance less expensive vehicles, and 1% earned on a $10,000 sale is much less than 1% earned on a $30,000 sale, even though more effort may be involved in the former. Because lower credit scores tend to correlate with larger dealer reserves, and because lower credit scores tend to be more prevalent among minority borrowers, a creditor's portfolio consisting of a disproportionate number of RISCs entered into by borrowers with below-average credit may show racial disparities simply because the creditor prefers RISCs with these race-neutral characteristics.

The Bureau could, if it wished to do so, control for factors like these in its fair lending analysis of indirect auto creditors. Indeed, the Bureau should strive to ensure that it compares only similarly situated buyers in its analysis. One method to control for these factors and prove that they are not contributing to observed disparities is to run a statistical regression. Doing so would not prejudice the Bureau's case against an indirect auto creditor. To the contrary, it would strengthen it. On the one hand, if the regression shows that a particular factor does not contribute to observed disparities, it can be eliminated as a potential proximate cause; on the other hand, if a particular factor is shown to contribute to observed disparities, it can be controlled and the Bureau can be more certain that any remaining disparities are attributable to discrimination on a prohibited basis.

Bureau documents reveal that the Bureau is fully aware that credit scores and other race-neutral factors *do* affect dealer reserve disparities. A November 19, 2014 decision memorandum to Director Cordray seeking authorization to settle enforcement actions against three creditors stated:

> "In order to evaluate the robustness of the results, BLDS re-estimated markup disparities using models that control for a variety of factors, including credit tier, new/used status, term, markup, and dealer. We included these controls to account for variations in markup based on these factors . . . When controlling for credit tier, new/used status and loan term, the disparities fell by approximately half for African-American and Hispanic borrowers and rose or remained the same for Asian/Pacific Islanders . . . . When controlling for dealer, the disparities fell 1-8 bps . . . . [W]e would likely not accept all of these controls as appropriate in negotiations regarding the analysis. In addition, in the unlikely event that we did consider including such controls as potentially appropriate, we would conduct additional analyses to refine our understanding of the impact of credit tier on markup. . . ."[114]

Notwithstanding this admission, the same memorandum admitted the factors were ignored prior to the Bureau's settlements with the three companies: "such factors *were not*

[114] November 19, 2014, Memorandum, 17 n.34.

included as controls in the analysis."[115] A separate memorandum confirms that the Bureau did not use controls in two additional cases as well.[116]

In a separate enforcement matter, even the Bureau's own BLDS expert, Dr. Bernard Siskin, advised the Office of Fair Lending to control for these race-neutral factors.[117] Internal documents reveal that Institution A was one of the Bureau's first targets for indirect auto lending enforcement action.[118] In a potential conflict of interest, Institution A hired Dr. Siskin to represent it before the Bureau. On December 20, 2012, the Bureau informed Institution A it had preliminarily concluded, based on disparate impact statistics, that the company had violated ECOA.[119] Institution A's January 17, 2013, PARR/NORA submission (its opportunity to explain why an enforcement action was not appropriate) stated that "Dr. Siskin analyzed the same data set analyzed by the Bureau, but added two explanatory variables in the model: (i) Metropolitan Statistical Area ("MSA"), and (ii) whether the customer financed a new or used vehicle,"[120] and found that after controlling for those two variables alone, the disparities almost completely disappeared.

Two drafts of a 2013 memorandum prepared by Assistant Director Ficklin on "Choice of Estimation Methods for Indirect Auto Lending Markup Disparities," show the Office of Fair Lending understood that Siskin's suggestions were sound, but still did not follow his advice; the drafts include comments by the Office of Fair Lending Deputy Assistant Director Rebecca Gelfond and Research, Markets and Regulations (RMR)

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[115] *Id.* at 13 (emphasis added).
[116] *See* Draft, "Analysis Work Performed," 1-3.
[117] *See infra*.
[118] *See* "Comparison of Preliminary Findings of 5 Indirect Auto Lender Examinations," (Institution A is among the 5 indirect auto creditors listed).
[119] December 20, 2012, PARR/NORA Letter to Institution A, 1 (included in February 14, 2014 CFPB Referral of Institution A Matter to DOJ).
[120] January 17, 2013, Institution A PARR/NORA Submission, 3 (included in February 14, 2014 CFPB Referral of Institution A Matter to DOJ).

Economist Bryce Stephens.[121] First, Assistant Director Ficklin's draft, prior to the redlined changes made by subsequent editors, says:

> "Regarding the estimation issue raised by [Institution A]'s expert, we had hoped that OR's [the Bureau's Office of Research] analysis of the two estimation methods would reveal that one or the other was plainly superior. ***However, OR has concluded that the two methods are both reasonable,*** but under different assumptions about the underlying cause of the disparities. The OR method assumes that members of different classes experience different markup outcomes because the auto dealers on average treat them differently on the basis of their class membership—in other words, markup disparities are caused by disparate treatment. The [Institution A] method, on the other hand, assumes that different outcomes occur not because class membership itself but because of some unidentified characteristics, such as income or education, that are correlated with class membership—in other words, markup disparities are caused by disparate impact. Unfortunately there is not enough information to know for sure which method will provide a disparity estimate that is closer to the truth. While we are relying largely on a disparate impact theory of lender liability, the choice of estimation method depends on how auto dealers decide markups. . . . . ***The OR Method may overestimate racial disparities by attributing exclusively to race differences that are driven in part by factors associated with geography***; whereas the [Institution A] Method will almost certainly underestimate racial disparities by assuming no race-based treatment whatsoever."[122]

Deputy Assistant Director Gelfond's comment in a subsequent draft recommends hiding the fact that the Office of Fair Lending is rejecting its own expert's opinion:

> *"I would rather attribute the argument to [Institution A] and not Siskin, given that we have engaged him for other institutions."*[123]

Another Gelfond comment suggests discrediting Institution A's (but not Dr. Siskin's) math, an idea that pleased someone in the Bureau's Office of General Counsel ("Legal"):

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[121] April_2013 Draft Memorandum, "Choice of Estimation Methods for Indirect Auto Lending Markup Disparities," Draft 1; April_2013 Draft Memorandum, "Choice of Estimation Methods for Indirect Auto Lending Markup Disparities," Draft 2.

[122] April_2013 Draft Memorandum, "Choice of Estimation Methods for Indirect Auto Lending Markup Disparities," Draft 1, 1-2 (underlined emphasis in original, all other emphasis added). The Office of Research is an office within the Division of Research, Markets, and Regulations. *See* CFPB Organizational Chart, *available at* http://files.consumerfinance.gov/f/201303_cfpb_org_chart.png.

[123] April_2013 Draft Memorandum, "Choice of Estimation Methods for Indirect Auto Lending Markup Disparities," Draft 1, 1 (emphasis added).

> "I think it would also be helpful to say (if we can) that the OR method relies on well accepted statistical methods of performing a regression and that the [Institution A] approach uses unconventional methods (of creating additional data points) . . . . In my conversation with Legal today, they found this compelling."[124]

Stephens, the RMR economist, responds by noting that Siskin's methodology is not unconventional at all:

> *"[Siskin]'s method is not unconventional* from other perspectives. His approach is equivalent (at least in the estimation of the disparities . . . not necessarily standard errors) to imputing the race and ethnicity using the probabilities for prediction of those characteristics. It may be novel in this context, but imputation is used widely in other settings."[125]

Stephens also notes:

> *"To be fair and realistic, buyers also participate in this process. A buyer does not necessarily need to accept what the dealer offers. The uncertainty here is whether dealers treat borrowers differently on the basis of race/ethnicity in the determination process. As for impact I suppose the issue may be how class membership is associated with other characteristics that are leading to inequitable outcomes.* "[126]

Assistant Director Ficklin ultimately recommended rejecting Dr. Siskin's opinion and again refused to control for race-neutral factors, despite acknowledging that doing so was probably unfair to Institution A (and subsequent Bureau targets):

> "[W]e recommend relying on OR's original method rather than adopting the alternative proposed by [Institution A]'s expert . . . . ***[T]here is no inherently 'right' answer to the question of which estimation method to use***; the choice can reasonably depend on the facts of a particular matter . . . [T]he OR Method is reasonable under the circumstances; even though there may be some risk of overestimating disparities, the alternative presents an equal (if not greater) risk of underestimating disparities and thus consumer harm. ***[T]he alternative method proposed by [Institution A] is not invalid or unreasonable, and thus could potentially suggest a lower bound on***

[124] *Id.* at 2 (emphasis added).
[125] April_2013 Draft Memorandum, "Choice of Estimation Methods for Indirect Auto Lending Markup Disparities," Draft 2, 2 (emphasis added) (ellipsis in original).
[126] *Id.* at 2 (emphasis added).

> ***disparities that we should bear in mind as we make decisions on how to proceed in the current auto lending matters."***[127]

In other words, recognizing that the Office of Fair Lending might be forced to accept Dr. Siskin's opinion and control for race-neutral factors, Assistant Director Ficklin suggested changing the Bureau's policy so that even smaller statistical disparities would be considered ECOA violations, thereby ensuring more auto finance companies will be subject to Bureau prosecution.

Although the Office of Fair Lending refused to adjust Institution A's disparate impact statistics to control for race-neutral factors, Institution A's decision to hire BLDS and Dr. Siskin may have nonetheless resulted in a better outcome for Institution A than other, similarly situated institutions. Internal documents reveal that Institution A had similar disparate impact statistics to seven other creditors, including Ally.[128]

However, in stark contrast to Ally's $98 million penalty and the attendant bad publicity, Institution A avoided an enforcement action. Instead, on March 19, 2014, Institution A quietly entered into a non-public Memorandum of Understanding (MOU), agreed to enhance the compliance procedures it requested of dealers that sold Institution A their RISCs, and (based on the draft MOU) set aside $22 million for a "Remuneration Fund" to distribute under a reimbursement plan to be approved by the Bureau, and, if there were money left in the Fund after reimbursement, pay the remainder to the Bureau for additional redress or disgorgement to the U.S. Treasury.[129]

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[127] *Id.* at 2 (emphasis added).
[128] *See* "Comparison of Preliminary Findings of 5 Indirect Auto Lender Examinations."
[129] *See* June 26, 2015, Memorandum, "Institution A Indirect Auto MOU Compliance – Forward Looking Remediation," 1, 3; Draft Institution A MOU, 1-8 (included in February 14, 2014 CFPB Referral of Institution A Matter to DOJ).

ECOA required the Bureau to refer the Institution A matter to DOJ, but Assistant Director Ficklin's referral letter was simply a single-paragraph description of the Bureau's "targeted review" of Institution A, along with detailed instructions on how to certify that the DOJ did not wish to open an investigation and a request for DOJ's "prompt consideration of this matter."[130]

Business Justification Defense

Even if the Supreme Court ultimately decides that disparate impact claims are cognizable under ECOA, and even if "allowing" dealers to negotiate RISC interest rates with their customers were a "practice" that *caused* dealer discrimination, and even if the Bureau's proxy method and estimation procedures identified genuine disparities, auto finance companies could assert a defense based on a legitimate business need. The Supreme Court forcefully restated this defense in *Inclusive Communities*:

> "[D]isparate-impact liability must be limited so employers and other regulated entities are able to make the practical business choices and profit-related decisions that sustain a vibrant and dynamic free-enterprise system. . . . And before rejecting a business justification . . . a court must determine that a plaintiff has shown that there is 'an available alternative . . . practice that has less disparate impact and serves the [entity's] legitimate needs.'"[131]

The Bureau's enforcement actions ignore the fact that the U.S. indirect auto financing market is highly competitive. No one creditor owns more than a small fraction of the market – as of 2013 only two creditors had a market share over five percent, and none over six percent.[132] In such a market, dealers will not assign RISCs to finance companies that don't make competitive offers, and finance companies that attempt to impose terms

[130] February 14, 2014, CFPB Referral of Institution A Matter to DOJ, 1-2.
[131] *Inclusive Communities*, 135 S. Ct. at 2518 (some alteration in original) (citing *Ricci v. DeStefano*, 557 U. S. 557, 578 (2009)).
[132] CRA/AFSA Report at 18 T.1.

and conditions (including costly, impractical compliance procedures) even slightly more burdensome than its rivals can lose most of their business.

The Bureau should understand by now that any auto finance company that reduces dealer reserve or moves to flat fee dealer compensation could suffer significant competitive harm. In fact, internal documents reveal that the Bureau is aware of the potency of this business justification. In a draft memorandum to Director Cordray and then-Deputy Director Raj Date, Assistant Director Ficklin said:

> "[W]e are mindful that requests for wholesale elimination of markup risk 'squeezing the balloon' and driving business to other entities against whom we are not taking action . . . . [N]o single actor is willing to suffer the competitive disadvantage that would come from changing their markup program unless others choose to or are forced to follow suit. [RMR] also says this is a 'bet the company' issue for lenders, which means if we target a lender in isolation they are likely to fight very hard against any Bureau action. We also understand from [RMR] that some lenders have stated that if they are forced to eliminate markup or significantly modify their own markup policies but there is no market-wide change, they may choose to withdraw from the market rather than compete against other lenders on an uneven playing field."[133]

Additionally, the Bureau initially offered Ally settlement terms with lower restitution and civil money penalty payments, provided that Ally would move to a flat fee structure, and the company refused: "Ally . . . stated that it cannot unilaterally reduce the rate spread limitations without substantial risk to its business. Ally notes that attempts to do so will result in dealers simply offering their contracts to Ally's competitors"[134] and "to do so would be 'corporate suicide.'"[135]

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[133] Draft Memorandum, "Auto Finance Discrimination Action Plan," 4.
[134] October 7, 2013, Draft Decision Memorandum, "Authorization to Seek a Settlement with Ally Financial, Inc. and Ally Bank and to File Complaint and Resolution in Federal District Court or to File a Resolution Administratively," 10.
[135] *Id.* at 23.

Not only does the Bureau know that finance companies are incapable of eliminating dealer discretion without committing "corporate suicide," but the Bureau knows that at least one finance company actually tried to do so and failed:

> "[Institution C] previously attempted to unilaterally move to flat fee compensation, *and lost significant market share as a result; it returned to dealer markup shortly thereafter."*[136]

Minimizing the Bureau's experiences with Ally, Institution A, Institution C, and many other finance companies, Assistant Director Ficklin informed Director Cordray:

> "As noted above, there exists anecdotal evidence to support the argument that being the only lender to shift to nondiscretionary dealer compensation would significantly undermine competitiveness."[137]

Furthermore, in a draft document it was clear that Bureau enforcement attorneys understood that in litigation auto finance companies would argue the "legitimate business need" to buy RISCs at prices that reflect the true value of their dealer-negotiated interest rates:

> "[W]e anticipate that Honda, [Institution B], and [Institution C] will contend that they had a competitive need to have dealer markups. Thus, Honda, [Institution B], and [Institution C] may be able to convince a court that they had a legitimate business need for their policies."[138]

It is hard to imagine a more legitimate business need for creditors to resist Bureau-mandated dealer compensation levels than that agreeing to do so would constitute "corporate suicide." Knowing that auto financers have a legitimate business need to make competitive offers to buy RISCs, the Bureau nonetheless brought enforcement actions intended to take away their ability to do so.

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[136] November 19, 2014, Decision Memorandum, "Authorization to Seek a Settlement or Commence Litigation," 19 (emphasis added).
[137] *Id.* at 20.
[138] *Id.* at 19.

The Bureau's "Global Solution"

The Bureau has publicly denied that the purpose of its indirect auto financing enforcement activities is to eliminate dealer discretion in negotiating RISC interest rates with borrowers.[139] For example, in a September 29, 2015, Financial Services Committee hearing, when asked whether he had been advised by senior staff that eliminating dealer reserve was the Bureau's goal, rather than admit it was so Director Cordray replied: "So, I would say yes, at some point in that discussion some people advocated that, others advocated other things, it doesn't mean that was the policy of the Bureau."[140] And, in an April 23, 2015, Financial Institutions and Consumer Credit Subcommittee hearing, when asked about the Bureau's objectives in issuing it indirect auto lending guidance, RMR's Associate Director David Silberman testified "[T]he Bureau's objective was to let the indirect auto lenders know our understanding of the law. . . ."[141]

However, internal documents reveal that the Bureau's objective from the beginning has been to eliminate dealer discretion and dealer reserve. In fact, the Bureau prepared a draft memo for a meeting with the Department of Justice in January 2013. Entitled "Auto Finance Discrimination Enforcement Action Plan," the memo laid out the Bureau's pitch to entice the Department of Justice to join its efforts:

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[139] One clue to the Bureau's motive, if not its purpose, is an article in *Automotive News* in which Chris Kukla, a senior vice president at the Center for Responsible Lending, explained a "theory that federal regulators . . . are still angry that when the CFPB was set up . . . franchised new-car dealerships won a 'carve out,' exempting them from the CFPB's jurisdiction." Mr. Kukla is quoted as stating that he believes Bureau's actions are "driven in part by the auto dealer exclusion." See Jim Henry, *Did dealers hurt themselves with the carve out?* AUTOMOTIVE NEWS (Aug. 20, 2014), available at http://www.autonews.com/article/20140820/BLOG13/308209996/did-dealers-hurt-themselves-with-the-carve-out.

[140] *The Semi-Annual Report of the Bureau of Consumer Financial Protection*, Hearing before the H. Comm. on Fin. Servs., 114th Cong. (September 29, 2015) (Mr. Duffy questioning), *available at* http://financialservices.house.gov/calendar/eventsingle.aspx?EventID=399697.

[141] *Examining Regulatory Burdens – Regulator Perspective*, Hearing before the Subcomm. On Fin. Insts. and Consumer Credit, 114th Cong. (April 23, 2015) (Mr. Barr questioning), *available at* http://financialservices.house.gov/calendar/eventsingle.aspx?EventID=398896#sthash.R8j2nabc.dpuf.

> "We want to involve you [DOJ], from the ground floor, on one of our most exciting initiatives. Through a coordinated set of enforcement actions against indirect auto lenders, we seek to eliminate discrimination in auto dealer compensation *and possibly eliminate dealer markup altogether*."[142]

Moreover, an April 3, 2013, briefing memorandum prepared for Director Cordray the day before his meeting with senior staff expressly acknowledged:

> "Our seriatim actions have *the express purpose* of eliminating discrimination at the selected institutions, either through considerably enhanced compliance programs or *through the elimination of dealer markup*."[143]

The extent of the Bureau's ambition to eliminate dealer markup is apparent in a May 29, 2012, Auto Finance Discrimination Working Group discussion, which described "Flat fee" dealer compensation – itself an elimination of dealer discretion – as merely "an improvement but can still result in in dealer/consumer alignment issues."[144] As another example, in a draft decision memorandum regarding publication of BISG's proxy methodology and disparity tolerances, Assistant Director Ficklin advised Director Cordray and Deputy Director Steven Antonakes:

> "There are serious risks to publishing our proxy methodology in the current environment. First, ***our Track 2 work is focused on moving indirect auto lenders towards a nondiscretionary form of dealer compensation, but an announcement on proxy methodology might suggest that lenders should instead eliminate the fair lending risk via a more robust compliance management system.*** There is evidence that one large auto lender has expressed interest in Track 2 because it believes our bulletin was in fact suggesting elimination of discretionary markup, and an announcement on proxy methodology would dispel that impression."[145]

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[142] January 2013, Draft, "Auto Finance Discrimination Enforcement Action Plan," 2, 3 (emphasis added).
[143] April 3, 2013, Briefing Memorandum, "Auto Finance Discrimination Initiative Update Meeting," 6 (emphasis added); *see also* Draft, "Status of Enforcement and Supervisory Matters," 5; "Auto Finance Discrimination Initiative – Update," 2 ("There are two ways to prospectively address discrimination caused by markup/reserve policies: [1] Eliminate markup and elect alternative compensation structure [2] Keep markup and monitor/correct disparities.").
[144] May 29, 2012, "Auto Finance Discrimination Working Group Discussion," 7.
[145] *See* May XX, 2013, Draft Decision Memorandum, "Potential Methodological Announcements," at 6 (emphasis added).

At first, the Bureau sought to make a splash by entering into a large settlement with a major industry player, as a way of encouraging other market participants to adopt a flat fee model. For instance, Director Cordray held a meeting with senior staff on May 20, 2013, the purpose of which was "to continue [] discussion around a market-tipping settlement that would resolve the discriminatory practices caused by dealer markup by eliminating markup at many major auto dealers."[146] And in an internal memorandum, the Bureau described this strategy as a "*Market-Tipping Consent Order*," the purpose of which was to "attempt to enter into a consent order with several auto lenders, enough to tip the market away from discriminatory practices in particular, or markup more generally."[147]

The Bureau had already identified the most vulnerable big creditor, Ally. Bureau examinations of Ally had begun in 2012 and culminated in a January 15, 2013, "Proposed Action, Response Request" (PARR) letter informing the company that an enforcement action was likely, based on the disparate impact its alleged practice of permitting discretionary dealer reserves had on African-American, Hispanic, and Asian-American car buyers whose RISCs Ally had purchased.[148]

As internal documents reveal, the Bureau had unusual leverage over Ally. For one thing, as a result of assistance that Ally (formerly GMAC) received from the Troubled Asset Relief Program, the federal government held a 73.8% ownership stake in the company at

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[146] April 24, 2013 Briefing Memorandum, "Auto Finance Discrimination Update Meeting," (referencing a planned May 20, 2013 meeting). The fact that senior staff wished to "continue" their discussions with the Director indicates that discussions of a market-tipping settlement were ongoing. The Briefing Memorandum also indicated that the Director and senior staff discussed Track 2 work at the same meeting. *See id.* ("We will discuss . . . the risks and benefits to publicizing broadly the proxy methodology at this time, and the protocol for initiating Track 2 contact with lenders. . . .").

[147] April 3, 2013, Briefing Memorandum, "Auto Finance Discrimination Initiative Update Meeting," 6 (emphasis added).

[148] *See* October 7, 2013, Draft Decision Memorandum, 1, 4.

the time.[149] For another thing, Ally had an application pending before the Federal Reserve to change its status to a financial holding company, and if the Federal Reserve did not approve the status change by December 24, 2013, Ally would have to divest its insurance and used-car remarketing operations.[150] Simultaneously, the FDIC was conducting a Community Reinvestment Act review of Ally and a poor rating by the FDIC could have precluded Ally from being granted financial holding company status.[151] In a preliminary draft of an internal decision memorandum to Director Cordray dated October 7, 2013, Bureau enforcement attorneys noted that "[a]ccording to its 2012 10-k, [Ally] received its last extension under the Bank Holding Act in December 2012, which expires December 24, 2013."[152] Settlement of the Bureau's fair lending investigation was a prerequisite for Ally's status change, and the draft memorandum raises the inference that the Bureau coordinated with FDIC and the Federal Reserve to ensure that this would be the case:

> "The Federal Reserve Bank has indicated that a finding of a fair lending violation would constitute a 'high hurdle' to [Ally's] ability to maintain its status as a holding company and most likely will result in the denial of holding company status. However, the Federal Reserve Bank also indicated that if Ally takes prompt and robust corrective action, it would consider such a factor in its determination. Furthermore, the FDIC is conducting a Community Reinvestment Act (CRA) review of [Ally] and has indicated that *Ally would, without considering the Bureau's findings, receive a rating of Satisfactory*. However, *the FDIC has stated that if the Bureau determines that*

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[149] *See* Congressional Research Service, "*Government Assistance for GMAC/Ally Financial: Unwinding the Government Stake*," (Jan. 26, 2015), available at https://www fas.org/sgp/crs/misc/R41846.pdf. In December 2013, the time during which Ally entered into its consent order with the Bureau, the government's ownership stake in Ally was 63.4%.

[150] *See id.*, 3; *see also* October 17, 2013, Draft Decision Memorandum, "Authorization to Seek a Settlement with Ally," 3, 22 ("In order to convert to a financial holding company, [Ally] . . . must . . . be considered well-managed under the BCHA. As such Ally may be strongly inclined to reach a timely and robust resolution of this matter if it can potentially result in [Ally] successfully converting to a financial holding company. Recent discussions with Ally on October 3 in which Ally expressed a strong willingness to settle this matter quickly are consistent with this analysis."); *see generally* Dakin Campbell, "Ally Wins Fed Approval to Change Holding Company Status," BLOOMBURG BUSINESS, December 23, 2013, *available at* http://www.bloomberg.com/news/articles/2013-12-23/ally-wins-fed-approval-to-change-holding-company-status.

[151] *See* October 7, 2013, Draft Decision Memorandum, 3.

[152] *Id.* at 3.

> *Ally violated the ECOA, it may result in a rating downgrade to Unsatisfactory, which would also preclude [Ally] from obtaining company status*. Likewise, if the Bureau cites an ECOA violation, it is unlikely that the FDIC will accord the required '2' rating for the management component of the CAMELS rating. The FDIC, like the Federal Reserve Bank, also indicated that prompt remedial action by Ally would be an important consideration in its rating determination. *Staff is in dialogue with both the Federal Reserve Board and the FDIC regarding these determinations.*"[153]

In the draft she reviewed, Assistant Director Ficklin (identifiable by her initials) highlighted this paragraph memorializing the Director's leverage, and commented: "Let's refrain from this discussion, and instead quote from the securities filing."[154]

Assistant Director Ficklin or an unknown editor also deleted the below language by the enforcement attorneys describing the Bureau as the only obstacle to Ally's gaining financial holding company status, and explaining how the Fed and FDIC had informed Ally that its application would be approved if it quickly settled the Bureau's allegations:

> "[Ally] would most likely maintain its status as a financial holding company but for the Bureau's action in this matter. However, if the Bureau cites an ECOA violation, it is unlikely that the FDIC, which supervises [Ally], will accord a "2" rating for the management component of the CAMELS rating and a Satisfactory CRA rating regardless of improvement in other areas. Significantly, the Federal Reserve Bank and the FDIC have indicated that if Ally also addresses the violations in a prompt and robust matter this will be an additional factor to weigh in its determination."[155]

Finally, the enforcement attorneys restated their confidence that, regardless of the facts, fighting the Bureau was not an option for Ally: "Thus, the likelihood of settling for an amount in our authority range appears reasonable; and staff believes that Ally recognizes legal and reputational risk of engaging in protracted litigation." [156] However, Assistant

[153] *Id.* at 3 (emphasis added).
[154] *Id.* at 3.
[155] *Id.* at 22-23.
[156] *Id.* at 23.

Director Ficklin or an unknown editor deleted the enforcement attorneys' language that followed below:

> "However if the Bureau seeks to force Ally to unilaterally adopt an alternate dealer compensation structure, e. g., flat fees, the likelihood of litigation increases exponentially and is almost certain in the absence of a broader market movement to such a compensation structure. In fact, *Ally has indicated that it cannot act unilaterally and to do so would be "corporate suicide."* Likewise, if Ally does not have an incentive to settle in order to achieve [] financial holding company status, the likelihood of litigation also increases substantially."[157]

This draft language made it clear that the enforcement attorneys recognized that the Bureau could not accomplish its goal of eliminating dealer discretion by attacking one auto finance company at a time. Even a company like Ally, which would be seriously injured if it refused to comply with the Bureau, believed it would be not merely injurious but "corporate suicide" to attempt to do so. This also suggests that Ally could have mounted a powerful "business necessity" defense to a disparate impact suit.[158]

In the final decision memoranda seeking authorization to settle with Ally initialed by Director Cordray, Bureau enforcement attorneys conceded that "[s]ome of the claims being made in this case present issues, such as the use of proxying and reliance on the disparate impact doctrine, that would pose litigation risk of enough significance to merit serious consideration prior to taking administrative action or filing suit in district court," but advised that such considerations were likely irrelevant, because "Ally might have a powerful incentive to settle the entire matter quickly without engaging in protracted

[157] *Id.* at 23 (emphasis added).
[158] *See supra*.

litigation" (i.e. the Bureau's ability to prevent it from achieving financial holding company status).[159] Ten days later, the attorneys further advised the Director:

> "Ally may be strongly inclined to reach a timely and robust resolution of this matter if it can potentially result in [Ally Financial Inc.] successfully converting to a financial holding company. Recent discussion with Ally on October 3 in which Ally expressed a strong willingness to settle this matter quickly are consistent with this analysis."[160]

Finally, on December 19, 2013, five days before its deadline to achieve financial holding company status, Ally signed a consent order obligating the company to pay $80 million in restitution for unsubstantiated disparate impact harm to unidentified victims of a legally mischaracterized "practice" (allowing car dealers to negotiate RISCs), plus an $18 million civil money penalty.[161] Just four days later, on December 23, 2013, Ally announced that the Federal Reserve had approved its application to become a financial holding company.[162]

Recognizing that it would be impossible to convince other individual finance companies to abandon dealer discretion,[163] the Bureau changed tactics. On December 23, 2014, the Bureau and Department of Justice wrote to a large group of finance companies

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[159] *Id.* at 22.

[160] October 17, 2013, Draft Decision Memorandum, "Authorization to Seek a Settlement with Ally," 22.

[161] *See* Consent Order, *In the Matter of Ally Financial Bank*, File No. 2013-CFPB-0010, ¶ 41 (Dec. 19, 2013), *available at* http://files.consumerfinance.gov/f/201312_cfpb_consent-order_ally.pdf; Press Release, Consumer Financial Protection Bureau, CFPB and DOJ Order Ally to Pay $80 Million to Consumers Harmed by Discriminatory Auto Loan Pricing (Dec. 20, 2013), http://www.consumerfinance.gov/newsroom/cfpb-and-doj-order-ally-to-pay-80-million-to-consumers-harmed-by-discriminatory-auto-loan-pricing/. As set forth in the settlement parameters approved by Director Cordray, one component of the restitution is "Consumers' indirect emotional distress damages" in the amount of $150 per person, for a total amount of up to $76 million. *See* October 17, 2013, Draft Decision Memorandum, "Authorization to Seek a Settlement with Ally," 19. A separate draft Ally term sheet and talking points prepared by Bureau staff indicate that emotional distress damages would be $175 per person. *See* Draft, "Ally Term Sheet and Talking Points," 5.

[162] See Press Release, Ally Financial, Ally Financial Granted Financial Holding Company Status (Dec. 23. 2013), https://media.ally.com/2013-12-23-Ally-Financial-Granted-Financial-Holding-Company-Status.

[163] One finance company that publicly adopted a flat fee compensation model in the wake of the Ally settlement was BMO Harris. In response, Director Cordray unusually issued a statement praising the company. See Consumer Financial Protection Bureau, Statement of CFPB Director Richard Cordray on BMO Harris Auto Lending Policy (Apr. 30, 2014), *available at* http://www.consumerfinance.gov/newsroom/statement-of-cfpb-director-richard-cordray-on-bmo-harris-auto-lending-policy/.

setting forth an offer for an "industry resolution" to "limit dealer discretion."[164] Under the terms of the offer, in exchange for the Bureau agreeing not to impose fines against the companies, the companies would have to choose between two options: (1) impose strict caps on dealer participation and submit its portfolio data "to the CFPB and the DOJ, at their request, semiannually for analysis and monitoring"; or (2) "maintain policies that do not allow dealers any discretion to set the contract rate."[165] The Bureau's offer was contingent on a sufficient number of companies whose originations collectively represented 25% of the market signing letters of intent to enter into consent orders by January 12, 2015.[166] Few if any of the finance companies agreed to the offer and the initiative failed.

Its plans for a true "global solution" having stalled, the Bureau instead began planning a major expansion of its individual enforcement actions.[167] A June 29, 2015, memorandum from Brian Kreiswirth to Assistant Director Ficklin and Deputy Assistant Director Gelfond reveals that the Office of Fair Lending's efforts to "focus largely on dealer markup and compensation policies" currently consist of investigations, examinations, or planned examinations of more than two dozen auto finance companies under the Bureau's jurisdiction—and recommends that the Bureau include multiple additional creditors as targets.[168]

In a more recent development, Bureau documents reveal that Assistant Director Ficklin may be considering an ECOA rulemaking: an August 3, 2015, legal memorandum to Patrice Ficklin from Bureau Counsel Chris Davis evaluates whether the Bureau has

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[164] Information provided confidentially to Committee staff.
[165] Information provided confidentially to Committee staff.
[166] Information provided confidentially to Committee staff.
[167] *See generally* "Track 2 – Overview," 5.
[168] June 29, 2015, Memorandum, "Recommendations for Auto Lending Global Efforts," 1. This is an extension of a longer-term plan of examinations and investigations. *See also* September 20. 2013, "Strategic Plan – Auto Initiative Track 1," 8 (noting that additional exams were scheduled for 2014).

"appropriate rulemaking authority pursuant to . . . [ECOA] to promulgate a regulation *prohibiting lenders from compensating dealers* based on the terms of a loan."[169] The Bureau considered such a rulemaking in September 2012, albeit under its UDAAP authority, and decided against proceeding, concluding that the rule "might exceed our regulatory authority because the potentially unfair, deceptive, or abusive actions are ostensibly those of the dealers, over whom we have no regulatory authority."[170] Assistant Director Ficklin's renewed interest in the matter may be an indication that her ultimate goal remains to impose a "global solution."

Conclusion

The Bureau's assault on the auto finance market is a textbook example of how regulators that don't understand business and economics can harm the very consumers they intend to protect. According to a recent analysis of the Bureau's settlements with Honda and BB&T by the *Wall Street Journal*, the end result of the Bureau's actions could be *higher* interest rates for some borrowers that over the life of a four-year $25,000 credit contract would add $586 in interest payments.[171] The information and documents accompanying this report should help auto dealers, finance companies, and consumers better understand the Bureau's flawed approach to indirect auto financing and compliance with ECOA.

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[169] August 3, 2015, Draft Memorandum, "Bureau Rulemaking Authority," 1.

[170] April 3, 2013, Briefing Memorandum, "Auto Finance Discrimination Initiative Update Meeting," 4; *see also* "Dealer Markup and Discrimination," 1 ("Options for global resolution: 1) Rulemaking that bans markup. . . .").

[171] AnnaMaria Andriotis and Gautham Nagesh, *Crackdown on Racial Bias Could Boost Drivers' Costs for Auto Loans*, WALL ST. J. (updated Aug. 31, 2015), *available at* http://www.wsj.com/articles/crackdown-on-racial-bias-could-boost-drivers-costs-for-auto-loans-1441038864.