



Justice Department and CFPB Announce \$98 Million Settlement of Auto Lending Discrimination Allegations

The U.S. Department of Justice and the Consumer Financial Protection Bureau recently announced a \$98 million settlement - the largest auto loan discrimination settlement to date - resulting from a nearly yearlong investigation into the fair lending practices of one of the largest auto lenders in the country. The settlement, the result of the first joint civil enforcement action by the DOJ and CFPB, resolves allegations that the lender engaged in an ongoing nationwide pattern or practice of discrimination against African-American, Hispanic and Asian/Pacific Islander borrowers since April 1, 2011, in violation of the Equal Credit Opportunity Act. Under the settlement, the lender will pay \$80 million in compensation for victims of past discrimination and \$18 million to the CFPB's Civil Penalty Fund. The lender must also either refund any discriminatory overcharges to borrowers for the next three years or significantly reduce disparities in unjustified interest rate markups.

The CFPB began investigating the lender's fair lending practices shortly after the bureau opened its doors in January 2012 and, as a result, referred the action for enforcement by the DOJ. The enforcement action alleged that approximately 235,000 African-American, Hispanic and Asian/Pacific Islander borrowers were charged higher interest rates because of their race or national origin, and not because of the borrowers' creditworthiness or other objective criteria related to borrower risk. From the consent [order](#) entered in the case, it appears that the regulators used a purely statistical analysis, comparing the total payments made over the life of the loans by borrowers of

different ethnicities with loans made to white borrowers with comparable incomes and credit scores.

As with all auto finance agreements, the contracts that the CFPB and DOJ analyzed did not contain actual information on the race or national origin of borrowers. To evaluate differences in dealer markup, the regulators assigned race and national origin probabilities to applicants using the proxy method used by many federal regulators to analyze fair housing data, deriving extrapolated joint race and national origin probabilities from borrowers' names and zip code information in the finance agreements. The CFPB and DOJ then used this extrapolated data in their models to estimate disparities in dealer markup on the basis of race or national origin. Based on this approach, the regulators determined that a typical African-American car buyer paid about \$300 in additional interest over the life of a loan compared with a white car buyer with similar income and credit scores and that Hispanic and Asian/Pacific Islander borrowers paid about \$200 more.

The regulators attributed these disparities to the lender's dealer markup policies. Rather than taking applications directly from consumers, the lender offers loans through more than 12,000 car dealers nationwide that submit loan applications to finance new or used cars on behalf of their customers. The lender, like many other large auto lenders, allows car dealers limited discretion to vary a loan's interest rate from the rate the lender initially sets, based on the borrower's objective credit-related factors. The lender pays

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dealers more for loans with a higher interest rate markup. The lender's policies limited dealer markup to 250 basis points for contracts with terms of 60 months or less, and to 200 basis points for contracts with terms greater than 60 months or for contracts made with borrowers who were assigned to the lowest two tiers of the company's credit scoring system. The CFPB and DOJ concluded that this system of dealer discretionary pricing directly resulted in qualified African-American, Hispanic and Asian/Pacific Islander borrowers paying more than qualified white borrowers.

The regulators alleged that the lender failed to monitor the dealers' interest rate markups for discrimination across its portfolio, failed to require its dealers to document their markup decisions, and for most of the relevant time period, did not offer comprehensive fair lending training to its network of dealers. Once the lender received preliminary findings of the CFPB investigation, it began monitoring the dealers for discrimination in interest rate markup and sanctioned some dealers for violations, requiring the dealers to undergo training. The settlement requires the lender to improve its monitoring and compliance systems and to report regularly on the results of its efforts.

Similar to the major credit card enforcement actions the CFPB brought against banks arising from the marketing of "add on" products by third party marketers, this new joint enforcement action sends a loud and clear message to auto lenders that they will be held responsible for disparities that arise in transactions originated by dealers that have markup discretion. Auto finance companies must implement fair lending policies, including measures for training and monitoring dealers, to prevent, identify and respond to potential discrimination.

Loeb & Loeb LLP's Consumer Financial Protection Bureau Task Force

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