



1700 G Street, N.W., Washington, DC 20552

February 6, 2014

The Honorable Colleen W. Hanabusa  
U.S. House of Representatives  
238 Cannon House Office Building  
Washington, DC 20515

Dear Congresswoman Hanabusa,

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

As you note in your letter, discriminatory auto lending is particularly harmful, as auto loans provide access to transportation, and are therefore a gateway to full participation in society. Thus, the Bureau takes very seriously its duty to address discrimination across the consumer credit industry, including indirect auto lending by depository and nonbank institutions.

You have asked the Bureau to provide a more detailed methodology used to determine disparate impact. Various proxy methodologies are publicly available and have been used for decades in a number of different civil rights contexts, including voting rights cases, Title VII cases, and constitutional challenges, including jury selection and equal protection matters. In addition, federal banking regulators have made clear that proxy methods may be used in fair lending exams to estimate protected characteristics where direct evidence of the protected characteristic is unavailable.<sup>1</sup>

In general, the proxy methodology used depends on the characteristic being proxied. For example, to proxy for gender, the Bureau relies on a first-name database from the Social Security Administration that reports counts of individuals by gender and birth year for

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<sup>1</sup> See *Interagency Fair Lending Examination Procedures*, at 12-13, available at <http://www.ffiec.gov/PDF/fairlend.pdf> (explaining that “[a] surrogate for a prohibited basis group may be used” in a comparative file review and providing examples of surname proxies for race/ethnicity and first name proxies for sex); see also, <http://www.philadelphiafed.org/bank-resources/publications/consumer-compliance-outlook/2012/first-quarter/fair-lending-webinar.cfm>.

first names occurring at least five times for a particular gender in a birth year.<sup>2</sup> The proxy method assigns a probability that a particular applicant is female based on the distribution of the population across gender categories (male or female) for the applicant's first name.

There are a greater variety of methods to proxy for race and national origin. A common method for proxying the probability that an applicant is Hispanic or Asian is to use the surname database published by the Census Bureau.<sup>3</sup> Another common method to proxy for race and national origin—typically referred to as “geocoding”—uses the demographics of the census geography (e.g., census tract or block group) in which an individual's residence is located, and assigns probabilities about the individual's race or national origin based on the demographics of that area.

Over the last decade, another method to proxy for race and national origin has been developed that integrates the surname and geographical approaches described above. This method was developed by health research economists,<sup>4</sup> and it combines the respective probabilities generated by the surname and geographical proxies. Published research has found that the integrated approach produces proxies that correlate highly with self-reported race and national origin data and is more accurate than using surname or geography alone.<sup>5</sup> The Bureau uses the integrated proxy as the primary method for proxying race and national origin in our non-mortgage analyses.

As we noted above, proxy methods vary based on the characteristic being proxied (race, national origin, or gender), and there are several reasonable methods of proxying for each of these characteristics. Some methods, for example, use solely surname or geocoding. The Federal Reserve Board, which publicly released some of its proxy methods in July, uses a surname Census database to determine if a borrower is Hispanic and geocoding to determine majority minority census tracts.<sup>6</sup> Other methods, like the Bureau's, integrate the same sources of data into a single proxy for race and national origin. We have chosen the integrated method because we consider it appropriate and helpful in evaluating the large and complex portfolios of the auto lenders supervised by the Bureau.<sup>7</sup> Similarly,

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<sup>2</sup> <http://www.ssa.gov/oact/babynames/limits.html>.

<sup>3</sup> <http://www.census.gov/genealogy/www/data/2000surnames/index.html>.

<sup>4</sup> Marc N. Elliott et al., *A New Method for Estimating Race/Ethnicity and Associated Disparities Where Administrative Records Lack Self-Reported Race/Ethnicity*, HEALTH SERVICES RESEARCH 43:5, Part I (Oct. 2008).

<sup>5</sup> Marc N. Elliott et al., *Using the Census Bureau's Surname List to Improve Estimates of Race/Ethnicity and Associated Disparities*, HEALTH SERVICES & OUTCOMES RESEARCH METHODOLOGY (2009) 9:69-83.

<sup>6</sup> <http://www.philadelphiafed.org/bank-resources/publications/consumer-compliance-outlook/outlook-live/2013/080613.pdf>.

<sup>7</sup> This information regarding the Bureau's proxy methodology was publicly disclosed by the Bureau on November 4, 2013, at the Wolters Kluwer 17<sup>th</sup> Annual CRA & Fair Lending Colloquium in Orlando, Florida, during the panel discussion titled, “What You Need to Know About the Use of Proxies & Surrogates in Non-HMDA Lending.” See

we expect lenders to choose a proxy method that will support a compliance management system commensurate with their size, organizational complexity, and risk profile.

You have also inquired about controls applied to the analysis of dealer participation. Each supervisory examination or enforcement investigation is based upon the particular facts presented by the entity under review. Thus, in our analyses we consider analytical controls that are appropriate to each particular entity. The controls are dependent upon the particular lender's policies, practices, and procedures. When lenders share with us the nature and results of their own analyses, we are open to hearing specific explanations for the decisions they have made to include particular analytical controls that reflect a legitimate business need. Because of this case-by-case determination we cannot identify each control that we apply in the analysis to ensure that borrowers are similarly situated. We would note, however, that creditworthiness factors like credit scores, debt to income ratios, characteristics of the collateral, and terms of the deal, like the amount financed, down payments, and any trade-in value, are already taken into account by lenders in arriving at the appropriate "buy rate." Because these factors are taken into account when determining the appropriate buy rate and are, therefore, considered in the overall interest rate the consumer receives, they are generally not appropriate to use as "controls" for an analysis of markup alone.

The raw data used to analyze a lender's portfolio is provided by each particular indirect auto lender under review. The Bureau's supervision program depends upon the full and frank exchange of information concerning supervised institutions' operations and compliance with Federal consumer financial law. Consistent with the policies of the prudential regulators, the Bureau's policy is to treat information obtained in the supervisory process as confidential and privileged.<sup>8</sup> Similarly, Bureau examinations are generally non-public and materials gathered during such an investigation are given confidential treatment.<sup>9</sup>

You have also asked whether the Bureau performed any market analysis with respect to the adoption of flat fees as a mechanism to compensate auto dealers for arranging

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*also* <http://www.consumerfinance.gov/blog/preventing-illegal-discrimination-in-auto-lending/>.

<sup>8</sup> CFPB Bulletin 12-01, The Bureau's Supervision Authority and Treatment of Confidential Supervisory Information, [http://files.consumerfinance.gov/f/2012/01/GC\\_bulletin\\_12-01.pdf](http://files.consumerfinance.gov/f/2012/01/GC_bulletin_12-01.pdf); 12 CFR § 1070.41; *see also* SR Letter 05-4, "Interagency Advisory on the Confidentiality of Nonpublic Supervisory Information," on the Federal Reserve Board's website at [www.federalreserve.gov/boarddocs/srletters/2005/SR0504.htm](http://www.federalreserve.gov/boarddocs/srletters/2005/SR0504.htm); 12 C.F.R. § 261; 12 C.F.R. §4.36.

<sup>9</sup> 12 C.F.R. § 1080.14. *See also* the consistent views of the industry in maintaining the confidentiality of these materials in Comment Letter Re: Docket No. CFPB-2011-0003, Disclosure of Records and Information, [http://www.aba.com/Advocacy/commentletters/Documents/70bca5c219ca40a59d35bace3c821a15cl\\_CFPB\\_IntFinDisclosure2011Sep.pdf](http://www.aba.com/Advocacy/commentletters/Documents/70bca5c219ca40a59d35bace3c821a15cl_CFPB_IntFinDisclosure2011Sep.pdf).

financing. The Bureau published CFPB Bulletin 2013-02, Indirect Auto Lending and Compliance with ECOA, to remind lenders of their responsibilities under ECOA and to offer guidance on how to address the identified risks to all indirect auto lenders within the jurisdiction of the Bureau. Consistent with Bureau procedures, the Bulletin was reviewed prior to issuance to ensure compliance with all legally applicable requirements. The Administrative Procedure Act (APA) sets out the principles by which federal agencies engage in regulatory activity and in applicable cases allows for comments from affected parties and the general public concerning an agency's activity. The APA does not impose a notice and comment requirement for general statements of policy, non-binding informational guidelines, or interpretive memoranda. Accordingly, the Bureau was not statutorily required to solicit comments about the Auto Bulletin.

Cost benefit analysis is an approach that is often utilized, when appropriate, in the administrative rule writing process to assess the impact of changes to regulatory requirements. The Auto Bulletin does not change or create any new regulatory requirements. Accordingly, a formal cost-benefit analysis is not appropriate in this circumstance.

Flat fees are mentioned in the Bulletin merely as one example of a non-discretionary compensation mechanism; the Bulletin does not mandate flat fees or any other particular system of dealer compensation. It is our understanding that a number of indirect auto lenders currently compensate auto dealers using a variety of non-discretionary or flat fee programs, and lenders may choose to adopt a variety of means, including, but not limited to, alternative compensation policies, to address fair lending risk. However, the Bureau has not undertaken a study of how market-wide adoption of a single non-discretionary compensation program would affect the availability of credit, nor has it attempted to analyze the impact of all the potential actions lenders may take to eliminate discrimination from their indirect auto lending programs. As a general matter, however, the Bureau believes that fair lending and the legitimate business needs of creditors are compatible.

Finally, you have asked whether lenders have any recourse if they are accused of discriminatory lending. It should be understood that any finding of discriminatory lending would be based upon an analysis of data and information provided by a particular indirect auto lender to the Bureau. During the course of a review, like the prudential regulators, the Bureau typically summarizes preliminary findings of discrimination and provides institutions an opportunity to respond formally to them. Because the Bureau is analyzing the lender's data, each lender has full access to the relevant data and the ability to identify and assess any methodological issues it deems worthy of bringing to the Bureau's attention during this process.

In addition, before Bureau staff recommends that the Bureau commence enforcement proceedings, they generally give the subject of such recommendation notice of the nature of the subject's potential violations and generally offer the subject the opportunity to submit a written statement in response. The decision whether to give such notice is discretionary, and a notice may not be appropriate in some situations, such as in cases of

ongoing fraud or when the Bureau needs to act quickly. The objective of the notice is to ensure that potential subjects of enforcement actions have the opportunity to present their positions to the Bureau before an enforcement action is recommended or commenced.

Thank you for bringing your concerns to the Bureau's attention and for the opportunity to respond. I look forward to working with you on this important issue as the Bureau continues to work to help markets operate more fairly and effectively for consumers and businesses.

Sincerely,

A handwritten signature in black ink, appearing to read "Richard Cordray". The signature is written in a cursive, flowing style.

Richard Cordray  
Director