Written Statement of the National Automobile Dealers Association

Submitted For the Hearing On

"The Semi-Annual Report of the Bureau of Consumer Financial Protection (CFPB)"

Before the Committee on Banking, Housing, and Urban Affairs

United States Senate

April 7, 2016

The National Automobile Dealers Association (NADA), a national trade association representing more than 16,000 franchised new car and truck dealers that collectively employ more than 1 million individuals,[1] is pleased to submit comments for the record as the Committee on Banking, Housing, and Urban Affairs engages in continuing oversight of the Consumer Financial Protection Bureau (CFPB). Particularly worthy of the Committee's attention is the CFPB's initiative, implemented through enforcement actions against auto lenders, to regulate dealer-assisted financing. This initiative is both (1) ***harmful to consumers*** – it threatens to eliminate customers' ability to receive a discounted annual percentage rate (APR) on their auto financing at a dealership; and (2) ***unnecessary*** – an alternative solution exists that fully addresses the fair credit concerns raised by the CFPB without eliminating a dealer's flexibility to discount the cost of credit for consumers. The CFPB's initiative also constitutes a back door attempt to regulate auto dealers, which Congress expressly prohibits in section 1029 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.[2]

Auto dealers have relationships with a wide variety of banks, credit unions and finance companies, so the dealers can offer consumers competitive financing right at the dealership. Dealer-assisted financing allows consumers to benefit from dealers' access to many lenders (including lenders the consumer could not access directly), all vying to provide vehicle financing to consumers. In this indirect financing model, the dealer absorbs the retail costs of the lender. The consumer often benefits, not only because the dealer is typically more efficient in overseeing those localized costs but also because the dealer has the flexibility to discount its retail margin by lowering the consumer's APR to beat a competing offer or to fit the customer's budget. Dealer-assisted financing routinely provides vehicle buyers with better finance rates than they could get on their own from a bank or credit union.

In March 2013, the CFPB issued informal indirect auto finance guidance which threatens to eliminate a dealer's flexibility to discount the APR offered to consumers to finance vehicle purchases.[3] In the three years since the issuance of this guidance, despite persistent Congressional

[1] NADA members are primarily engaged in the retail sale and lease of new and used motor vehicles, and also engage in automotive service, repairs, and parts sales. Last year America's franchised new car and truck dealers sold or leased approximately 17.5 million new cars and light duty trucks. NADA members operate in every congressional district in the country, and the majority of our members are small businesses as defined by the Small Business Administration.

[2] Congress retained the Federal Trade Commission, Federal Reserve Board and the Department of Justice's authority over dealers at the federal level.

[3] CFPB Bulletin 2013–02, issued March 21, 2013: http://files.consumerfinance.gov/f/201303_cfpb_march_-Auto-Finance-Bulletin.pdf

oversight, the Bureau has provided little transparency regarding the formulation of this guidance and the potential adverse effects on consumers.

With the CFPB's actions likely to raise the cost, and in turn reduce the availability, of credit for car buyers,[4] **NADA appreciates the Committee's review of the CFPB's actions on auto financing** to ensure the Bureau is acting in the best interests of consumers and basing its policies on sound analysis**.**

The auto finance guidance is a classic case of the government not working properly. The CFPB released its guidance without prior notice, an opportunity for public comment, or even interagency coordination. What makes this specific guidance problematic is that the CFPB chose to avoid the rulemaking process and use "guidance" as a way to make a major change in policy which is effectively eliminating a dealer's ability to offer customers discounts on credit.

1. **The Bureau is not acting in the best interests of auto consumers**. The CFPB proceeded without considering the impact of its directives on auto consumers.[5] And the CFPB continues to press its fair credit initiative in a way that eliminates or significantly constrains consumer discounts. Of course, consumers are better served when they are able to leverage the competitiveness of the marketplace to negotiate lower interest rates on auto financing.

2. **The Bureau is not basing its policy on sound analysis**. The CFPB is attempting to eliminate or constrain dealers' ability to discount credit utilizing (1) a proxy analysis for determining the ethnicity of borrowers that the CFPB knows to be flawed[6] and (2) a fair credit enforcement theory that fails both (i) to compare only "similarly situated" customers[7] and (ii) to account for legitimate, competitive business factors that explain any pricing differentials that may exist.

The Department of Justice (DOJ) has noted repeatedly that the Equal Credit Opportunity Act does not ban pricing discretion or pricing differentials between groups, if the differences are based on a legitimate business rationale. This principle is consistent with the Supreme Court's recent decision

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[4] AnnaMaria Andriotis and Gauthan Nagesh, "*Crackdown on Racial Bias Could Boost Drivers' Costs for Auto Loans*," Wall Street Journal (Aug. 15, 2015).

[5] Section 1022 of the Dodd-Frank Act requires the CFPB to consider, when issuing a rule, the potential benefits and costs (including the potential reduction of consumer access to financial products and services) that could be caused by such a rule. In response to a letter sent by 22 Senators on this topic, <u>the CFPB acknowledged that it never studied how eliminating a dealer's ability to discount credit would affect the cost of credit paid by consumers</u>. (Letter from the Hon. Richard Cordray, Director, CFPB to Senators Portman (R-OH) and Shaheen (D-NH) (Nov. 4, 2013.)

[6] The CFPB's own analysis of its methodology revealed errors as high as 20 percent in estimating individuals' ethnicity. An independent research study found that the CFPB's proxy methodology can overestimate certain populations by 41 percent. Charles River Associates, *Fair Lending: Implications for the Indirect Auto Finance Market* (Nov. 2014).

[7] For a correct fair lending analysis, the CFPB must ensure the consumers compared are similarly situated by holding key variables constant, including the following: (1) the amount financed; (2) trade-in value; (3) competition in the local market; (4) market conditions; (5) demand and desirability for the vehicle; (6) consumer's payment capacity; and (7) whether the car is new or used. Also, manufacturers provide dealers sales incentives that motivate a dealer to arrange financing a car at a discount or loss if it achieves certain sales goals. If this factor is present, it must be taken into consideration as a dealer often has a vested interest in selling the car at a financing discount both to make the sale and to create customer loyalty that results in return business for parts, service, and future car purchases.

in *Texas Department of Housing & Community Affairs v. The Inclusive Communities Project, Inc.,*[8] a decision which CFPB Director Richard Cordray approvingly cited last month before the House Financial Services Committee to justify its policy to eliminate dealer discounts.

As an alternative to the CFPB's guidance, NADA has endorsed a fair credit compliance program based entirely on a DOJ model, and we continue to urge the Bureau to embrace this common sense approach to addressing the fair credit concerns it has raised. In 2014, NADA developed its *Fair Credit Compliance Policy & Program*, based on prior work by the DOJ, which addresses fair credit risk in the showroom while also preserving a dealer's ability to discount credit. NADA, the National Association of Minority Automobile Dealers, and the American International Automobile Dealer Association jointly released this program, and numerous fair credit experts across the country have endorsed this approach. To date, the CFPB has declined to provide a reasonable rationale for failing to adopt this effective, DOJ-inspired alternative.

The DOJ-based program recognizes certain business reasons as legitimate to explain differentials in the amount of dealer discounts in the financing of automobiles, yet the CFPB refuses to acknowledge these neutral factors or to provide a rationale for rejecting them. The neutral, business-related factors that are often necessary to gain a customer's business include the following:

- the customer has a **monthly payment**/budget constraint;
- the dealer **"<u>meets or beats</u>"** a competing offer from a bank, credit union, or another dealer;
- the dealer offers a **promotional financing campaign** extended to all buyers, or all buyers of a particular vehicle, on the same terms;
- the customer qualifies for an **employee incentive program;**
- there are **inventory reduction considerations** that prompt the dealer to offer a financing discount in order to move certain vehicles off of its lot (since the dealer accrues interest on those vehicles until they are sold).

The DOJ model addresses fair credit concerns by promoting a standardized approach while preserving the flexibility needed to allow consumers to benefit from today's competitive auto financing marketplace. Most significantly, the DOJ prudently recognized that eliminating credit discounting in the showroom would deprive consumers of the ability to obtain a lower, discounted rate from the dealer when there is a legitimate business reason for the lower rate, i.e., a reason unrelated to the customer's background. (In contrast, the CFPB's guidance could largely *eliminate* a customer's ability to negotiate a lower interest rate in the showroom.)

The Senate should pass S. 2663, the "Reforming CFPB Indirect Auto Financing Guidance Act", introduced by Sen. Moran (R-KS). The bill would rescind the CFPB's flawed auto finance guidance, and make the Bureau more transparent and accountable when issuing future auto finance guidance. The bill provides for a public comment period, coordination with regulatory agencies that possess authority over dealers, and a study of the impact of the guidance on small businesses and,

[8] *Inclusive Communities, decided on June 25, 2015, held*, among other things, that "[g]overnmental or private policies are not contrary to the disparate-impact requirement unless they are artificial, arbitrary, and unnecessary barriers" and noted that businesses should be able to make "practical business choices and profit-related decisions." *Texas Dep't of Housing and Community Affairs v. Inclusive Communities Project, Inc.*, 576 U.S. ___ (2015).

most importantly, consumers.[9] In particular, before issuing new auto finance guidance, S. 2663 would require the CFPB to:

- provide notice and a period for public comment;
- make public any studies, data, and analyses upon which the guidance is based;
- consult with the Federal Reserve Board, Federal Trade Commission and Department of Justice; and
- study the cost and impact of the guidance on consumers as well as women-owned, veteran-owned, minority–owned, and small businesses, including in rural areas.

S. 2663 is a moderate bill that does not dictate a result or tie the CFPB's hands. The bill merely allows for transparency and public notice so the public has an opportunity to analyze and to comment on the CFPB's attempt to change the auto financing market via "guidance."[10] It protects fair credit laws and their enforcement in order to safeguard equal opportunity in auto financing. For all of these reasons, the companion bill, H.R. 1737, introduced by Reps. Guinta (R-NH) and Perlmutter (D-CO), overwhelmingly passed the House on November 18 by a vote of 332-96 with strong support from Members across the political spectrum, including 88 Democrats.

The current system of optional, dealer assisted financing is fair and competitive, and boosts access to affordable credit for consumers. The Senate should provide careful oversight to ensure that the CFPB's actions do not unnecessarily and disproportionally hurt consumers, especially those with less-than-perfect credit, since those customers will be less able to afford any increase in rates and face even more limited options to buy a car or truck to meet their work and family needs. Any disruption in the highly-efficient, dealer assisted model can only be justified if supported by reliable and sound analysis. Yet, the CFPB continues to attempt to set the *manner* and dictate the *amount* of dealer compensation for arranging financing, despite a clear prohibition in Dodd-Frank against regulating dealers.[11] These significant flaws in the CFPB's policy could have been avoided if the Bureau had employed a transparent process and sought information on effective ways to build on the consumer benefits of the current auto finance model.

Senators should (1) vote for S. 2663 to provide much needed transparency, and (2) urge the CFPB to embrace the DOJ-based program that simultaneously addresses potential fair credit concerns and preserves consumers' access to affordable auto credit.

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[9] The CFPB took none of these essential steps before issuing its far-reaching guidance.

[10] Significantly, the process for issuing guidance in S. 2663/H.R. 1737 is consistent and in accordance with OMB's practices on agency guidance documents. The Bulletin on "Agency Good Guidance Practices" sets forth general policies and procedures to ensure that guidance documents of Executive Branch departments and agencies are developed with appropriate review and public participation, accessible and transparent to the public, and of high quality.

[11] Chris Kukla, of the Center for Responsive Lending and a "persistent critic of auto dealers and lenders," has 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 stated that he believes CFPB'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.

Attachments

Bill Text, S. 2663

Myths & Facts, S. 2663

NADA/NAMAD/AIADA *Fair Credit Compliance Policy & Program*

4 Pinocchios: "Fact Checker: Warren's false claim that 'auto dealer markups cost consumers $26 billion a year'", Washington Post (May 5, 2015).