

STUDY DEMONSTRATES THAT CFPB'S METHODOLOGY SUPPORTING ITS AUTO FINANCE GUIDANCE IS FUNDAMENTALLY FLAWED

Issue

In 2013, the Consumer Financial Protection Bureau (CFPB) established a new policy via “guidance” to eliminate a dealer’s ability to discount credit for consumers. The pretext for this anti-competitive policy is the CFPB’s claim that auto dealers give slightly better discounts on auto credit rates to nonminority consumers than minority consumers. A study by a prominent research firm, Charles River Associates (CRA), evaluated the CFPB’s methodology for measuring pricing disparities in auto finance and found several significant flaws that show the CFPB’s methodology to be inaccurate, incomplete, and unreliable.

Background

Federal law prohibits a creditor from considering or inquiring into the race or ethnicity of the borrower when extending auto credit. To establish the race or ethnicity of the borrower, CFPB relies on “proxies.” The proxy method used by the CFPB is the Bayesian Improved Surname Geocoding (BISG) method. This statistical method makes a best guess of the borrower’s race or ethnicity based on the borrower’s last name and address.

To test the accuracy of the CFPB’s method, CRA applied BISG to a large database of consumer mortgage transactions, where each borrower’s race and ethnicity is known. The study found that the CFPB’s method frequently fails to correctly identify a consumer’s actual race or ethnicity. Further, the CFPB’s method does not consider legitimate business factors (such as a dealer discount to “meet or beat” a competing offer or the need to satisfy a monthly budget constraint of the consumer) that can explain pricing differences between groups.

The CFPB has publicly disagreed with the CRA study, but does not state any basis for its disagreement and has yet to formally respond to the November study.

Key Points

- **The CRA study found that the CFPB’s method to ascertain a borrower’s race or ethnicity is inaccurate.** For example, the study incorrectly assumed the population of applicants for vehicle financing and the general population in a given zip code is the same. The study also found that the CFPB’s proxy methodology overestimates the number of African-Americans by 41 percent.
- **The CRA study determined that the CFPB’s methodology is incomplete since it does not consider legitimate business reasons why dealer discounts may vary among consumers.** For example, the CFPB does not consider that dealers routinely try to “meet or beat” a competing offer from a bank, credit union, or another dealer to gain a customer’s business. Dealers also will discount an interest rate to move a slow-selling model.
- **The CFPB is aware its methodology is unreliable, yet it continues to rely on flawed assumptions.** Despite acknowledging its methodology overestimates some minority groups, (a CFPB September 2014 report reveals that its methodology overestimates the African American population by 20 percent) the bureau continues to threaten enforcement actions against auto lenders in an attempt to eliminate or limit dealer discounts in the showroom.