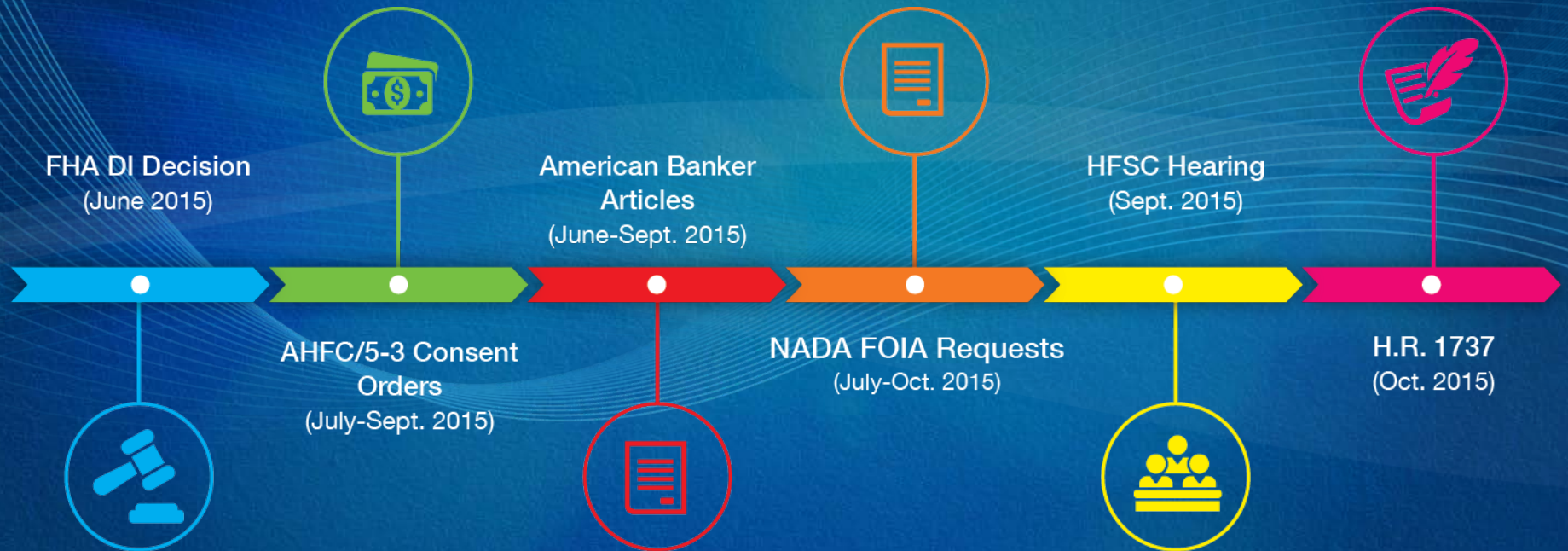


Fair Credit Update

Andrew Koblenz and Paul Metrey (NADA)
Damon Lester (NAMAD)

Recent Fair Credit Developments



Overview



Yesterday v. Today



The Honda Finance Consent Orders
-- Getting under the Hood --



Moving Forward



Where we've been...

Guidance to Finance Sources

cfpb Consumer Financial
Protection Bureau
1700 G Street NW, Washington, DC 20552

CFPB Bulletin 2013-02

Date: March 21, 2013

Subject: Indirect Auto Lending and Compliance with the Equal Credit Opportunity Act

This bulletin provides guidance about compliance with the fair lending requirements of the Equal Credit Opportunity Act (ECOA) and its implementing regulation, Regulation B, for indirect auto lenders that permit dealers to increase consumer interest rates and that compensate dealers with a share of the increased interest revenues. This guidance applies to all indirect auto lenders within the jurisdiction of the Consumer Financial Protection Bureau (CFPB), including both depository institutions and nonbank institutions.

Background

While consumers may seek financing for automobile purchases directly from a financial institution, many seek financing from the auto dealer. The auto dealer may provide that financing directly or it may facilitate indirect financing by a third party such as a depository institution, a nonbank affiliate of a depository institution, an independent nonbank, or a "captive" nonbank (an auto lender whose primary business is to finance the purchase of a specific manufacturer's automobiles).

In indirect auto financing, the dealer usually collects basic information regarding the applicant and uses an automated system to forward that information to several prospective indirect auto lenders. After evaluating the applicant, indirect auto lenders may choose not to become involved in the transaction or they may choose to provide the dealer with a risk-based "buy rate" that establishes a minimum interest rate at which the lender is willing to purchase the retail installment sales contract executed by the consumer for the purchase of the automobile. In some circumstances, the indirect auto lender may exercise discretion in adjusting the buy rate, making underwriting exceptions, or modifying other terms and conditions of the financing as a result of additional negotiation between the indirect auto lender and the dealer.

The indirect auto lender may also have a policy that allows the dealer to mark up the interest rate above the indirect auto lender's buy rate. In the event that the dealer charges the consumer an interest rate that is higher than the lender's buy rate, the lender may pay the dealer what is typically referred to as "reserve" (or "participation"), compensation based upon the difference in interest revenues between the buy rate and the actual note rate charged to the consumer in the retail installment contract executed with the dealer. Dealer reserve is one method lenders use to compensate dealers for the value they add by originating loans and finding financing sources. The exact computation of compensation based on dealer markup varies across lenders and may vary between programs at the same lender. After the deal is consummated with the consumer, the

“Eliminating Dealer Discretion”



The Fallacy of Flats

Beware of Claims that Flat Fees Eliminate a Dealer's Risk of Violating Fair Credit Laws

Since at least early 2013, the Consumer Financial Protection Bureau (CFPB or Bureau) has exerted substantial pressure on indirect finance sources to change the way they compensate automobile dealers for originating credit contracts with consumers. The Bureau has taken this action based on its belief that finance source compensation policies that allow dealers to exercise discretion in determining the amount they earn for participation* or “dealer reserve”) create a “significant risk” that certain groups of consumers (based on race, national origin, or other prohibited factors) will pay more dealer participation than other groups of similarly situated consumers, in violation of the federal Equal Credit Opportunity Act (ECOA).

Because the Bureau believes that dealer pricing discretion is the source of this fair credit risk, the Bureau declares that finance sources can take one of two actions to address it. A finance source can *constrain* dealer pricing discretion by imposing a series of controls on that discretion and monitoring the dealer participation earned in the credit contracts it purchases from dealers. Alternatively, a finance source can forgo this process by *eliminating* dealer pricing discretion and compensating dealers with “another mechanism, such as a flat fee per transaction, that does not result in discrimination.”¹

But if finance sources were to adopt a flat fee pricing mechanism,² would that indeed eliminate dealer pricing discretion and the risk of unlawful pricing disparities that the Bureau maintains results from such discretion? For the

individual finance source that adopts a flat fee policy, the CFPB states that the answer is “yes.” However, for the dealers who sell paper to that finance source as well as to other finance sources, the answer is decidedly “NO.”

The reason flat fees would not eliminate dealer pricing discretion – even if every finance source were to adopt them – is simple. Dealers typically sell credit contracts to a variety of finance sources, each finance source would set its own flat fee, and dealers would exercise discretion in selecting the finance source to which they would sell the contract. Thus, far from eliminating dealer discretion, flat fees would merely shift the primary exercise of that discretion from *inter-finance source discretion* (that is, the discretion a dealer exercises in determining how many basis points to add to the wholesale buy rate offered by a single finance source) to *intra-finance source discretion* (that is, the discretion a dealer would exercise in determining which flat fee amount to choose from among the competing offers it received from multiple finance sources).

Flat fees therefore would not eliminate dealer pricing discretion. This in turn means that, to the extent such flat fees would not eliminate that risk. And, if this risk of discrimination exists for the consumer, then a risk of liability for that discrimination exists for the dealer.³ Consequently, in identifying the adoption of flat fees as a silver bullet for eliminating fair credit risk, the Bureau has come up with a purported solution for individual finance sources and individual finance sources alone. It has not come up with a solution for the other two parties to an indirect financing transaction – the consumer and the dealer.⁴

¹ CFPB Bulletin 2013-02 (Mar. 21, 2013).
² A “flat fee pricing mechanism” generally refers to a finance source policy that compensates dealers for originating consumer credit contracts with a flat dollar amount per transaction, a percentage of the amount financed, or another fixed formula for determining the dealer’s compensation. These policies do not permit dealers to exercise any form of pricing discretion, such as offering consumers a discounted annual percentage rate (APR) in order to earn their business.

³ As with finance sources, dealers are exposed to significant liability for ECOA violations.
⁴ A broad industry adoption of flat fees in response to pressure from the CFPB would also create the risk of steering consumers to high-cost credit contracts, as dealers would be incentivized to sell their credit contracts to the finance source that offers the highest flat fee (which likely would result in higher APRs being paid by consumers).



Recent Consent Orders



Evergreen Bank (May 2015)

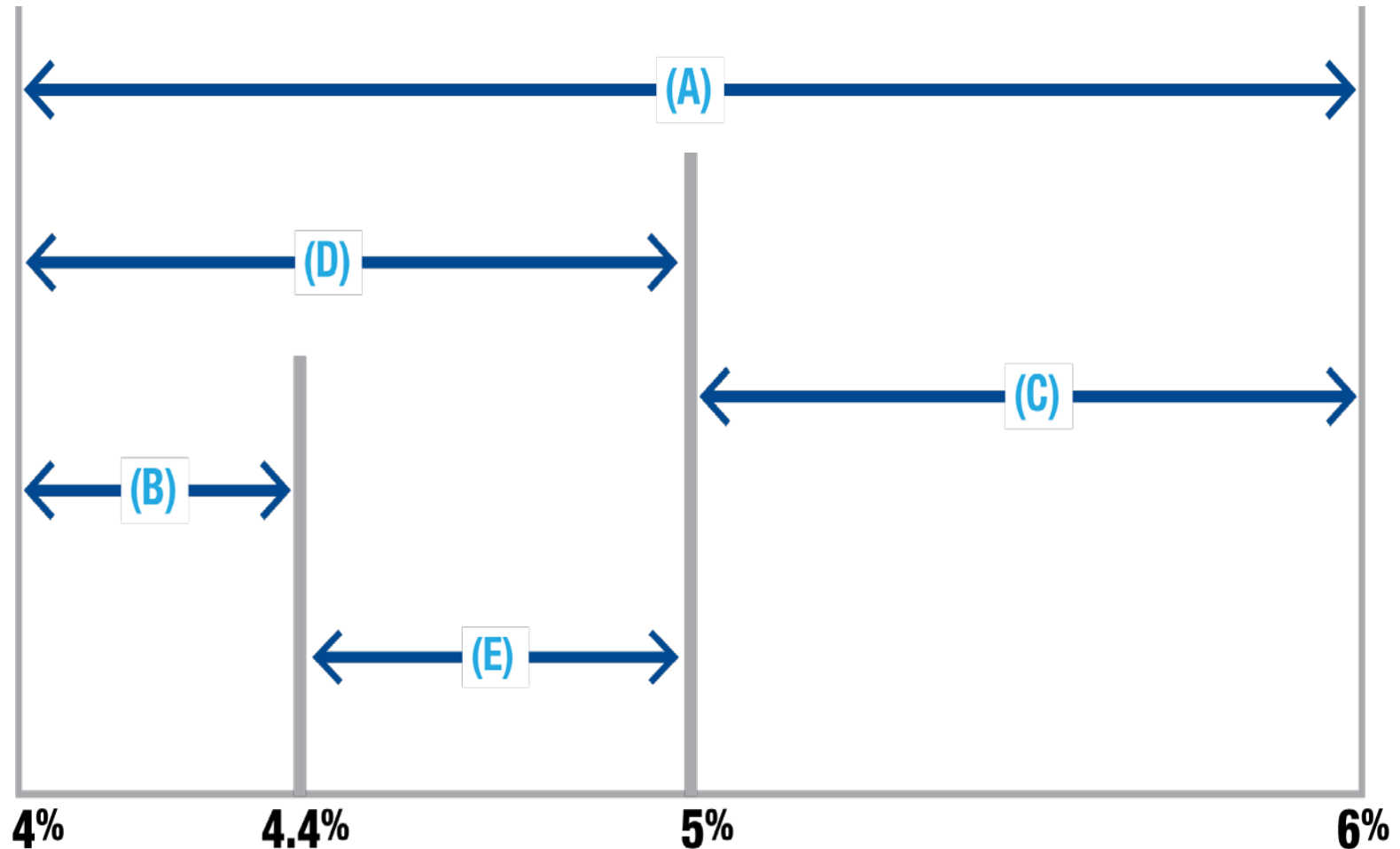


Honda Finance (July 2015)



Fifth Third Bank (September 2015)

Honda Finance Consent Order



Regulation through Enforcement

“[DOJ and the CFPB] announced today a groundbreaking settlement....”

“The settlement is especially noteworthy because of the company’s commitment to significantly limit the discretion of car dealers to charge interest rate markups on Honda loans.”

“Honda’s proactive decision to move to a new pricing and compensation system demonstrates industry leadership and represents a significant step towards protecting consumers from discrimination.”

“...other auto lenders should take note of today’s action....”

“We hope that Honda’s leadership will spur the rest of the industry to constrain dealer markup to address discriminatory pricing.”

DOJ Press Release (7/14/15)

NADA-NAMAD-AIADA Response



FOR IMMEDIATE RELEASE

Dealer Associations: CFPB/Honda Consent Order Severely Reduces Consumers' Ability to Negotiate Lower Auto Loan Rates

MCLEAN, Va. (July 14, 2015) — Leaders of the National Automobile Dealers Association (NADA), the National Association of Minority Automobile Dealers (NAMAD), and the American International Automobile Dealers Association (AIADA) issued the following statements in response to a July 14 consent order entered into by the government and American Honda Finance Corp.:

"Today's government-imposed order will hamstring the ability of thousands of consumers to negotiate lower interest rates with their local auto dealership," said NADA Chairman Bill Fox. "This enforcement action artificially constrains the right of consumers to benefit from interest rate reductions of up to 1% of the APR on their next auto loan."

"Every person deserves to be treated honestly and fairly when purchasing and financing their next car or truck — no exceptions and no excuses," said NAMAD President Damon Lester. "Today's restriction of consumer rights is entirely unnecessary because a better alternative exists — the *Fair Credit Compliance Policy & Program* recommended by our associations. That alternative, which is modeled on prior Department of Justice consent orders, fully addresses fair credit concerns without displacing the ability of consumers to obtain discounted rates."

"There's no getting around the fact that this enforcement action is going to reduce the savings consumers depend on when financing a new vehicle," said AIADA Chairman Brad Hoffman. "Everyone in our industry is mystified as to why the government continues to overlook its own common-sense approach in favor of the anti-consumer methods forced on Honda Finance."

About NADA

NADA, founded in 1917, represents more than 16,100 new-car and -truck dealerships, with both domestic and international franchises. For more information, visit www.nada.org.

About AIADA

Established in 1970, AIADA is the only association whose sole purpose is to represent America's 10,000 international nameplate automobile franchises that sell and service the following brands: Acura, Aston Martin, Audi, Bentley, BMW, Ferrari, Honda, Hyundai, Infiniti, Jaguar, Kia, Land Rover, Lexus, Maserati, Maybach, Mazda, Mercedes, MINI, Mitsubishi, Nissan, Porsche, Rolls Royce, Scion, Smart, Subaru, Toyota, Volkswagen and Volvo. These retailers have a positive economic impact both nationally and in the local communities they serve, providing more than 500,000 American jobs. Visit AIADA online at www.aiada.org.

-more-

- Criticizes government's constraint on consumer's ability to obtain discounted rates
- Also criticizes fact that "government continues to overlook its own common-sense approach" to issue
- Reasserts that a "better alternative" exists to address government's fair credit concerns

NAMAD
NATIONAL ASSOCIATION OF MANUFACTURER AUTOMOBILE DEALERS

NADA
NATIONAL AUTOMOBILE DEALERS ASSOCIATION

American International
Automobile Dealers

Fair Credit Compliance POLICY & PROGRAM

Credit Application

Step One
Your full name exactly as it appears on your Social Security card

1. Last name

2. First name

3. Middle name

4. Number and Street (include apt. number)

5. City and State (include zip code)

6. Your date of birth

7. Sex

8. Your Social Security Number

9. Your telephone number

10. Your e-mail address

11. Your driver's license number

12. Your vehicle identification number (VIN)

13. Your vehicle make and model

14. Your vehicle year

15. Your vehicle color

16. Your vehicle type

17. Your vehicle mileage

18. Your vehicle condition

19. Your vehicle title

20. Your vehicle registration

21. Your vehicle insurance

22. Your vehicle license

23. Your vehicle title

24. Your vehicle registration

25. Your vehicle insurance

26. Your vehicle license

27. Your vehicle title

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95. Your vehicle title

96. Your vehicle registration

97. Your vehicle insurance

98. Your vehicle license

99. Your vehicle title

100. Your vehicle registration

Fair Credit Program Testimonials

Here's what prominent industry compliance attorneys are saying about the optional

NADA/NAMAD/AIADA Fair Credit Compliance Policy & Program



"When dealers concerned about the CFPB campaign against dealer reserve ask how best to protect themselves, I advise that they should adopt a fair lending policy that removes individual discretion in setting rates. The NADA/NAMAD/AIADA policy is the gold standard for a policy that creates rate consistency in the FBI department. Dealers that have fully implemented it and insist on continuing compliance not only improve protection against losses, they improve productivity by preventing shortcuts."

Michael Charapp, Esq.
Charapp & Weiss, LLP



"Unlawful discrimination claims are not going away. And, the U.S. Supreme Court's recent Inclusive Communities decision not only confirms this, but will likely fuel regulatory and plaintiff action in this realm. Unfettered FBI discretion is no longer viable. The NADA/NAMAD/AIADA Fair Credit Compliance Policy & Program, when implemented properly and followed, puts the dealer in the best possible position to respond to unlawful discrimination challenges."

Patty Covington, Esq.
Hudson Cook, LLP



"The NADA compliance programs are the best in the industry, and the NADA/NAMAD/AIADA Fair Credit Compliance Policy & Program is no exception. It advocates dealer adoption of a comprehensive Fair Credit compliance program that includes several prudent steps, as well as the creation of evidence through the use of the Dealer Participation Certification Form to successfully respond to finance source inquiries and defend against regulatory investigations."

Daniel J. Doman, Esq.
RouteOne LLC



"I believe the NADA/NAMAD/AIADA Fair Credit Compliance Policy & Program can resolve the issues raised by the CFPB relating to discretionary pricing in dealer interactions with consumers, assuming it is faithfully executed as described by NADA."

Rick Hackett, Esq.
Hudson Cook, LLP



"In light of the Supreme Court's ruling in the Inclusive Communities case, and given the Department of Justice's stated support for the principles embodied in the NADA/NAMAD/AIADA Fair Credit Compliance Policy & Program, adopting and applying the NADA/NAMAD/AIADA program gives a dealer the best possible defense to a claim of disparate impact credit discrimination by whomsoever asserted."

Randy Henrick, Esq.
Dealertrack Technologies, Inc.

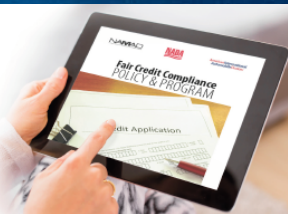


"The NADA/NAMAD/AIADA Fair Credit Compliance Policy & Program, when properly implemented, provides as close to a safe harbor from federal credit discrimination claims as anything out there. In our experience, dealers who implement the NADA/NAMAD/AIADA program are uniquely equipped to respond to the continual parade of lenders seeking information on dealership finance compensation practices."

Jonathan Morrison, Esq.
Auto Advisory Services, Inc.

What prominent industry compliance attorneys are saying about the optional

NADA/NAMAD/AIADA Fair Credit Compliance Policy & Program



"The NADA/NAMAD/AIADA Fair Credit Compliance Policy & Program is very well thought out and an effective way for dealers to manage their ECOA risk in pricing credit to customers."

Jean Noonan, Esq.
Hudson Cook, LLP



"I strongly recommend implementation of the NADA/NAMAD/AIADA Fair Credit Compliance Policy & Program to our dealer clients. In my opinion, it a well-designed program that should be relatively easy to implement and that should provide a dealership with a strong defense against alleged Equal Credit Opportunity Act violations based on disparate impact."

Paul Norman, Esq.
Boardman & Clark LLP



"Every dealer should adopt the NADA/NAMAD/AIADA Fair Credit Compliance Policy & Program. It is based upon established law which will protect dealers from liability. The NADA/NAMAD/AIADA program is an excellently designed program and its implementation by any dealer should be relatively simple."

Terrence J. O'Loughlin, J.D., M.B.A.
Reynolds and Reynolds



"Dealers need to build a defensible position against the CFPB's scrutiny of dealer assisted financing. The NADA/NAMAD/AIADA Fair Credit Compliance Policy & Program, with its roots in government approved precedent, provides dealers with the defense they need against claims of discriminatory conduct in credit pricing."

Shaun K. Petersen, Esq.
MacMurray Petersen & Shuster LLP
(counsel to National Independent Automobile Dealers Association)



"To survive and thrive in today's regulatory environment, dealers absolutely need to adopt a fair credit policy and use it every day with every deal. The NADA/NAMAD/AIADA Fair Credit Compliance Policy & Program is an excellent tool for doing just that. I highly recommend it."

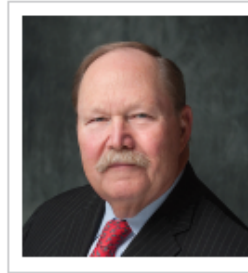
Halbert B. Rasmussen, Esq.
Arent Fox LLP



"CU Direct understands that an essential part of its mission is to help credit unions better serve their member-owners. Clear, consistent and compliant fair lending policies are one of the most effective ways to do just that while mitigating the risk of potential disparate impact claims. By adopting and implementing a program such as the NADA/NAMAD/AIADA Fair Credit Compliance Policy & Program, dealers are better positioned to partner with lenders while limiting their own exposure."

Thomas H. Wolfe, Esq.
Moore Brewer Wolfe Jones Tyler & North
(counsel to CU Direct)

Fair Credit Program Testimonials



“I believe the NADA/NAMAD/AIADA Fair Credit Compliance Policy & Program can resolve the issues raised by the CFPB relating to discretionary pricing in dealer interactions with consumers, assuming it is faithfully executed as described by NADA.”

Rick Hackett, Esq.
Hudson Cook, LLP

Program Overview



American International
Automobile Dealers

Fair Credit Compliance Policy & Program at a Glance



In January 2014, the National Automobile Dealers Association (NADA), the American International Automobile Dealers Association (AIADA), and the National Association of Minority Automobile Dealers (NAMAD) released to their members the *Fair Credit Compliance Policy & Program*. The following is a brief overview of the program.

PURPOSE

The *Fair Credit Compliance Policy & Program* is an optional program that is designed to strengthen a dealership's efforts to comply with fair credit laws.

BACKGROUND

Dealers and the auto lenders to which they sell their credit contracts may be sued by a federal or state regulator and/or by an individual plaintiff for a fair credit violation if they are found to have discriminated against a credit applicant based on his or her race, national origin or other prohibited factor. This applies to both intentional

and unintentional "disparate impact" discrimination. (Disparate impact discrimination is generally proven by looking at past transactions and comparing the amount of dealer participation—also known as dealer reserve—paid by different groups of consumers who are similarly situated. If there is a pricing disparity between these groups that cannot be explained by legitimate business factors, the dealer and the auto lender may be held liable for a fair credit violation.)

BASIS AND DESCRIPTION OF THE PROGRAM

In 2007, the Department of Justice (DOJ) entered into consent orders with two dealerships to resolve allegations of disparate impact discrimination. The program is modeled on the fair credit compliance program contained in these consent orders. The core of the program is as follows:

- The dealership establishes a pre-set Standard Dealer Participation Rate (SDPR) which the dealership uniformly adds in each transaction to the wholesale buy rate it has chosen to determine the APR that the dealership offers to the customer.
- The dealership only deviates from that APR if an allowable business reason (i.e., a good faith, pro-competitive reason unrelated to the customer's background) exists to include a lower amount of dealer participation in the offer of credit to the customer.

ADOPTING THE PROGRAM

A dealership that chooses to adopt the program should complete the steps below and ensure the program is tailored to its individual needs and circumstances.

STEP 1

Create a *Fair Credit Policy* that states the dealership's strong commitment to fair credit compliance and consider prominently posting the policy where it can be viewed by both consumers and employees. (A fair credit policy template is available for this purpose at Appendix A of the program.)

STEP 2

Create a *Fair Credit Compliance Program* as described in Steps 3-6 that carries out the *Fair Credit Policy*. The dealership's leadership (board of directors or other governing body) must review and formally adopt the program.

STEP 3

Identify who and what is covered by the program and the purpose of the program.

STEP 4

Appoint a program coordinator (PC) to develop and oversee the program. The PC should have the necessary time, expertise and seniority to perform this function.

STEP 5

Direct the PC to establish the dealership's pre-set SDPR and provide that the dealership will only deviate from the SDPR if an allowable business reason exists to include a lower amount of dealer participation in the offer of credit.

- Identify the allowable businesses reasons when the dealership may deviate from the SDPR. (The program includes seven allowable business reasons that support a deviation, such as the need to satisfy a customer's monthly budget constraint, the need to meet or beat a more competitive credit offer or the existence of a

manufacturer subvention program for which the customer qualifies. These are the same seven reasons that are contained in the DOJ's 2007 consent orders.)

- Require each dealership employee who makes a credit offer to record on the Dealer Participation Certification Form at Appendix D (i) the SDPR, (ii) the final dealer participation rate, and (iii) where the two differ, the allowable business reason for deviating from the SDPR.
- Ensure that the PC or his or her designee reviews the form to ensure it was properly completed. If it was not, have the PC take necessary corrective action. (The reviewer should not have been involved in the transaction.)

STEP 6

Establish the training, oversight and reporting tasks that the PC must complete to ensure the program is faithfully executed. This includes identifying the documentation that the employee making the credit offer must retain to support a deviation from the SDPR.

MAINTAINING THE PROGRAM

As with any regulatory compliance program, ensure the dealership's "Fair Credit Compliance Policy & Program" is continuously carried out and adjusted as necessary to meet its objective of strengthening the dealership's efforts to comply with fair credit laws.

The NADA/NAMAD/AIADA Fair Credit Compliance Policy & Program is available as a pdf and the template program is available in MS Word format at www.nada.org/faircredit. Review the publication in full (including the disclaimers and limitations associated with the program) and consult with the dealership's legal counsel before deciding whether and how to adopt the program.

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Questions