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REVIEW & OUTLOOK

Washington's Latest Bank Heist

No victims yet, but regulators guess that there's bias in car loans.

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Federal regulators extorting settlement money out of big banks is an old story in the Obama Administration. But most of the cash extracted to date has been justified in the name of punishment for the financial crisis. Now the Justice Department is teaming up with the Consumer Financial Protection Bureau (CFPB) to punish banks for events that may not have even occurred.

Staff at the consumer bureau, honoring the wishes of founder Senator Elizabeth Warren (D., Mass.), are inclined to harass any unfortunate souls in their jurisdiction who offer different interest rates to different customers. The bureau-crats would like to harass auto dealers in particular for negotiating rates with car buyers who choose dealer financing. But the 2010 Dodd-Frank law that created the bureau specifically prohibits them from regulating car dealers.

So they've gone the indirect route and for the last two years have been threatening enforcement actions against banks that provide the loans offered by the dealers to their customers.

The pretext for this war on bargaining is a CFPB claim that auto dealers are charging minority buyers slightly higher interest rates on car loans than they're charging similar white customers. It's really more of a guess than a claim because so far the bureau hasn't presented evidence of particular actions by dealers to discriminate against customers on the basis of race.

Rather, the feds look at data from thousands of loans and, based on last names and addresses of the borrowers, guess who's black, who's white, and so on. They're using a statistical method called Bayesian Improved Surname Geocoding. This has some utility in the medical field to draw broad conclusions about health outcomes across different populations, but it is of limited value in verifying the ethnicity of a particular person.

A study conducted by Charles River Associates for the American Financial Services Association applied this method

to the names in a set of mortgage data (where the race of each borrower is known) and found that the Bayesian method for counting African-Americans was off by 41%.

The consumer bureau's official position, expressed by Director Richard Cordray at a House Financial Services hearing last month, is that "we disagree with the results" of the Charles River study. But neither Mr. Cordray nor his staff will explain why they disagree with an analysis that appears to demolish the entire basis for their campaign against auto lending.

Details, details. The important thing is to suck cash out of banks and prevent car dealers from negotiating rates by threatening to brand them as racists if they don't toe the line. The bureau and Justice scored an early victory in December 2013 when they persuaded Ally Bank to agree to pay \$18 million in penalties and \$80 million in damages for alleged discriminatory impact in its lending.

But that settlement comes with an asterisk because Ally admitted no wrongdoing, didn't agree to eliminate dealer pricing discretion, and agreed to the deal shortly before it received federal approval to be a financial holding company. A cynic—er, political realist—might say Ally was simply paying for a license to lend.

The bureau has cut a few smaller deals privately with unnamed banks but larger settlements may be on the horizon. J.P. Morgan, the Administration's favorite political ATM, warned in a recent filing that it is discussing the issue of possible "statistical disparities" in auto lending with Justice.

With more than \$50 billion in auto loans on Morgan's balance sheet at the end of last year, real or imaginary disparities wouldn't have to be that large to generate a fat settlement for the Beltway bandits. And it's likely that not a single car salesman or banker will have been proven to have discriminated against anyone. ■