CFPB Taskforce Report on Federal Consumer Financial Law: How Might It Affect Auto Finance Regulation?

April 2, 2021 | L. Jean Noonan

Just a little over a year ago, I was sworn in as a member of the newly created Taskforce on Federal Consumer Financial Law, along with my four fellow taskforce members. The taskforce was the brainchild of Consumer Financial Protection Bureau Director Kathleen Kraninger, who believed that the CFPB would benefit from recommendations on how to strengthen and update consumer financial protection laws and regulations.

The application criteria looked interesting when I saw the announcement — previous experience as a senior federal executive, a national reputation in consumer financial services, and lots of original research in consumer finance. I checked the first two boxes but not the third one. However, I received a lot of encouragement to throw my hat in the ring, so, along with about 100 others, I did.

It turned out that my lack of scholarly research was not a problem because my four brilliant colleagues on the taskforce had more than enough. But I had something they lacked — I dedicated the last two decades of my career to advising consumer financial service providers on how to navigate the challenging requirements of federal (and state) laws. Combining that with 15 years at the Federal Trade Commission enforcing these laws and a decade as the chief counsel of a bank regulator, I felt I had a well-rounded perspective on the needs of consumers, the compliance issues facing the industry, and the supervisory concerns of banking regulators. But not everyone agreed.

In fact, the composition of the taskforce was controversial from the beginning. Consumer advocates and some members of the press attacked it as beholden to industry, a charge I found curious since at least three of us were former FTC executives with strong records of aggressive consumer protection. But the CFPB was sued anyway to stop the taskforce's work. As of the date our report was released on January 5, that litigation was still ongoing.

Our report has two volumes. The first is about 800 pages covering the research on consumer financial services and the regulatory landscape — a fascinating read for anyone in our industry or who is interested in the topic. The second is a more manageable 100 pages of recommendations based on the research. One of my colleagues, a law professor, likened Volume I to "showing our work" — even if you don't think we ultimately got the answer right, you can see how we got there!

Volume II contains 102 recommendations we grouped under 19 subject-matter areas. Not all recommendations address issues of special interest to auto dealers and auto finance companies, but many do. I will start with my favorites.

One of the most controversial CFPB initiatives of the past decade was its focus on alleged discrimination in auto finance pricing — specifically the spread between the wholesale prices quoted by indirect finance sources and the retail rate quoted by the dealer, sometimes called the "markup." The CFPB was understandably concerned about discrimination — quoting higher rates on the basis of race or national origin is illegal and indefensible. But the CFPB staff's "evidence" of illegal pricing was fraught with technical and legal flaws, and its remedies did not get at the heart of any real concern.

That's the basis for recommendation #66 — "The Bureau and the Federal Reserve Board should amend the Commentary to Regulation B to provide that good faith implementation of the Fair Credit Compliance Program or comparable program constitutes one method of preventing discrimination in pricing credit offered by retail sellers." The Fair Credit Compliance Program, sponsored by the National Automobile Dealers Association and two other trade associations, tackles pricing discrimination at its source and, if faithfully implemented, ensures that illegal discrimination will not occur. None of the CFPB's complicated settlement agreement terms would have guaranteed the same good result. The taskforce's recommendation would have the CFPB (and the FRB, which has rulemaking authority over dealers outside the CFPB's jurisdiction) add a provision to the Reg. B Commentary that would offer a safe harbor to dealers who follow the terms of the Fair Credit Compliance Program. Especially with the new CFPB administration, which is certain to emphasize anti-discrimination in auto finance, a safe harbor is likely to increase the adoption by dealers of the NADA Fair Credit Compliance Program and ensure greater protection of consumers and compliance certainty for dealers.

Here are a couple of other recommendations related specifically to auto finance. Recommendation #64 urges the CFPB to focus its pricing discrimination concerns on dealers within its jurisdiction rather than trying to address concerns indirectly by looking at contracts purchased by auto finance sources. A dealer's illegal discrimination cannot accurately be detected this way; any one dealer's pricing will be submerged in the pricing of hundreds of other dealers whose contracts the creditor buys. And, drilling down to the pricing of each dealer in the indirect creditor's portfolio will not offer a complete picture of the dealer's pricing practices — most dealers assign contracts to many different finance sources. Moreover, the disparate impact theory the CFPB used was a huge stretch of this theory. The CFPB claimed that the required "facially neutral" factor in the finance source's policy was the "discretion" it gave dealers to set the retail rate within a limited range. In another disparate impact case, the Supreme Court cogently observed that "discretion" was not a policy — rather, it was the *absence* of a policy.

In recommendation #65, the taskforce stressed that any evaluation of a dealership's pricing should use appropriate control variables in its pricing regression analysis, something the CFPB staff declined to do in its enforcement actions from 2013 to 2016. But, controlling for legitimate factors that affect a dealer's markup is not easy. Unless the dealer has adopted the NADA Fair Credit Compliance Program, the dealer's reason for offering one consumer a different markup than another consumer received will not be specifically recorded. In the absence of such a record, the CFPB should accept proxies for such factors — just as it uses proxies for race, national origin, and sex. There are many legitimate business reasons for which a dealer may charge higher average markups to consumers with low credit scores, such as the increased time needed to find an assignee willing to buy the contract and to resolve stipulations, like proof of employment and residence. In contrast, the dealer can quickly assign the contract of a consumer with a high credit score and often has several choices among which to choose. We have found that often little difference exists in average markup between racial and ethnic groups in the same credit score range.

The recommendations include other items of interest for dealers. Recommendation #45 would relieve the dealer of any obligation to provide an adverse action notice when it denies an application because no third-party source would agree to purchase the application and each third-party creditor provides an adverse action notice. This recommendation addresses a long-standing problem for dealers. Often, they do not know why the finance sources to which they shopped an application denied it. Indeed, each finance source may have had its own unique reasons. Forcing the dealer to guess the reasons adds nothing to the real reasons each finance source gives the consumer and, indeed, may even result in an inaccurate guess.

A long-standing problem dealers face in advertising credit and lease terms is compliance with the very prescriptive requirements of Regulations Z and M. These requirements have led to tiny disclosures in print and electronic ads that consumers cannot read and oral disclosures in audio ads that are spoken so fast that no one can understand them. The taskforce recommends in #43 that these "trigger term" disclosures be replaced with principle-based disclosures, which would ask: Is the credit or lease term advertising misleading or deceptive without additional information?

The taskforce has many recommendations that may especially benefit indirect creditors without any reduction in protections for consumers. In fact, many may increase consumer well-being. Here are just a few of them:

- As finance sources make online applications more available to consumers, reforms to the E-Sign Act become ever more important (##48-50).
- Expanding credit services to consumers with limited English proficiency requires regulatory attention to ensure expansion of availability without unfair or deceptive practices (#46).
- Alternative data should be used responsibly to expand credit services to consumers with no or thin credit files (##1-3).
- Streamlining or eliminating the need to license sales finance creditors can benefit consumers by increasing competition and reducing costs (#13).
- Researching the accuracy of credit reports (#18) will help ensure creditors make underwriting and pricing decisions based on the best available information.
- Adverse action notices should be simplified and made more useful to consumers by allowing creditors to give as a denial reason "insufficient credit score" when also giving the "key factors" under the Fair Credit Reporting Act for why the credit score was too low (#44).
- CFPB enforcement should focus on harm to consumers by setting the optimal deterrence amount (#55); avoiding "regulation by enforcement," which unfairly sidesteps notice-and-comment rulemaking (#58); and providing additional guidance to improve compliance practices through "Enforcement Highlights" (#57).
- Required disclosures should be simplified by focusing more on avoiding consumer harm (#62).
- The CFPB should clarify its interpretation of its application of disparate impact in light of Supreme Court precedent (#63) and allow public comment on a proposed interpretive policy.
- The CFPB should implement practices to promote inclusion of consumers who may be outside

current underwriting standards but still represent good risks for auto creditors (##69, 76-77).

- Creditors should be allowed to provide Gramm-Leach-Bliley Act privacy notices more cost-effectively to those consumers who value them (#83).
- Supervised auto finance sources should be evaluated on their actual compliance or noncompliance rather than on the extent to which their Compliance Management Systems conform to the CFPB's view of an optimal CMS; in other words, the measure should be compliance or compliance failures rather than compliance policies (#98).

One question I am often asked is whether, in light of the 2020 election results, the taskforce's report is "dead on arrival." My answer is an emphatic "no." From the beginning of our work, the taskforce was instructed to take the "long view" to produce recommendations that would look forward for at least 20 years. Our model was the 1972 report of the National Commission on Consumer Finance, which has influenced consumer financial protection reform for almost a half-century.

The taskforce knew that not every one of our 102 recommendations would appeal to every CFPB director, to every Congress, or to every state. Certainly, the COVID-19 pandemic erupting soon after we began our work was not helpful to our process. But, after one year of intense study and debate, with valuable input from the public, the CFPB staff, academics, and other federal and state agencies, these recommendations represent our best (and unanimous) ideas.

I hope every stakeholder in our industry will give them a close look. And, if you have feedback on the report for me, I welcome it! The two volumes of the report are available on the CFPB's website.

The world of consumer financial services is rapidly changing. These recommendations should help ensure that consumers have access to the financial services they want at competitive prices; that the regulatory rules-of-the-road are clear, flexible, and fairly enforced; and that consumers have the protection from harm they deserve.

HUDSON COOK

Celebrating its 25th anniversary in 2022, Hudson Cook, LLP is a national law firm representing the financial services industry in compliance, privacy, litigation, regulatory and enforcement matters.

7037 Ridge Road, Suite 300, Hanover, Maryland 21076
410.684.3200

www.hudsoncook.com