The Train Keeps on Rolling: Toyota Motor Credit Settles ECOA Charges for Dealer Pricing

March 2, 2016 | L. Jean Noonan

Since last fall, when the Consumer Financial Protection Bureau and the Department of Justice announced their settlements with Fifth Third Bank, many of us have been waiting to see which auto finance creditor would be next. That wait ended last month, when Toyota Motor Credit Corporation, the country's largest captive auto finance company, became the fifth indirect auto creditor to settle Equal Credit Opportunity Act discrimination charges with the CFPB, the DOJ, or both agencies.

If you've lost count, the list began with companion settlements by the agencies against Ally Bank and Ally Financial Services in December 2013. Ally led this parade with the biggest consumer redress amount - $80 million - and the only civil money penalty - $18 million. After a lull of more than a year, the DOJ settled a small case against Evergreen Bank Group for ECOA claims related to dealer pricing of motorcycle contracts it bought. (I know, I know, motorcycles aren't cars, but the financing works the same way.) Evergreen paid $395,000 into a consumer redress fund. Because this was a case referred to the DOJ by the Federal Deposit Insurance Corporation, the CFPB wasn't part of this settlement. And because the DOJ cannot get civil penalties for ECOA violations, Evergreen didn't pay one.

Then in quick succession, the DOJ and the CFPB announced their companion settlements with American Honda Finance Corporation and Fifth Third Bank. As a reward for being "industry leaders" in adopting a new dealer compensation model, neither Honda nor Fifth Third was required to pay a civil penalty. They both paid sizable amounts into consumer redress funds, however. But the centerpiece of these settlements was a new paradigm for dealer compensation.

At first glance (okay, maybe even at second glance), the Toyota settlements look an awful lot like the Honda and Fifth Third orders. None of the three orders contains a civil penalty. All three require payments into consumer redress funds and have very similar procedures for sending checks to certain consumers. Each settlement provides the creditor with three options for compensating dealers who assign auto finance contracts to them.

Like the Honda and Fifth Third orders, the Toyota order contains one dealer compensation option (Option Three) that removes any dealer discretion to set the contract rate. This is the CFPB's pipe dream option - no one expects Toyota to choose it. Option Two is also the same in each order. This option is patterned on the DOJ's 2007 settlements with Pacifico Ford and Springfield Ford and on the National Automobile Dealers Association's Fair Credit Program, which was also based on Pacifico and Springfield. In Option Two, the dealer sets a standard markup over the buy rate, which it can lower on a deal-by-deal basis for a legitimate reason, such as a competitive offer or a payment constraint. The dealer must provide Toyota the basis for the exception and the details or documentation of the particular circumstances of the exception.

Option One is the key provision because it is the one that indirect creditors are most likely to adopt. In all three orders, the markup is capped at 125 basis points for contracts of 60 months or less and 100 basis points for longer-term contracts. The indirect creditors are also permitted to pay dealers an additional amount, which is not based on the discretionary markup. This non-discretionary payment is intended to compensate the dealer for lost revenue from the lower markup caps.

The agencies like these low caps because, with less wiggle room, they think that dealers' average markup amounts to minorities and non-minorities are likely to be closer. Dealers *dislike* these low caps because they provide less room to accommodate customers who demand a lower rate. And unless the assignee pays additional non-discretionary compensation, dealers lose revenue that, for many, is critical to their profitability.

The non-discretionary compensation has the potential to address the lost revenue problem for dealers. But how to address the need to meet competition? Honda, Fifth Third, and Toyota have persuaded the agencies that dealers must be able to offer a rate below their buy rate to meet or beat offers from their competitors. No doubt recognizing the benefit of this competition to consumers, the agencies permit all three finance sources to drop the buy rate, so long as they document the amount and source of the competitive offer.

Here's where you need your magnifying glass to see how the Toyota settlement differs from the previous ones. The Honda order says in footnote 3 that Honda's policies must "eliminate Dealer Discretion" in deals with a reduced buy rate due to a competitive offer. That means the dealer cannot add a markup and is limited to receiving whatever nondiscretionary dealer compensation Honda offers. Footnote 4 of the Fifth Third order says the same thing. In contrast, the Toyota order does not prevent dealers from marking up a rate that has been reduced due to competition. This difference is likely to appeal to Toyota dealers because it gives them the potential for greater compensation.

In announcing the Toyota settlement, CFPB Director Richard Cordray declared that Toyota would not raise its buy rate to cover the cost of nondiscretionary dealer compensation. Good luck trying to find that restriction in the Toyota settlement; it isn't there. So what was Director Cordray talking about? Toyota, like the indirect creditors that settled before it, has to submit its dealer compensation plan to the CFPB and the DOJ and receive their "non-objection." This nonpublic document is where many details of the new dealer compensation systems are located. This is an opaque way to set policy because it keeps important details hidden from the public and makes it hard for other indirect auto creditors to understand exactly what the agencies are requiring. The odds are good that Toyota's dealer compensation plan will contain its pledge not to raise buy rates to cover any additional compensation Toyota chooses to pay. The CFPB caught some critical press when it became clear that other indirect creditors were raising buy rates to pay for the dealer's lost revenue from lower markup caps. One can fairly assume the Bureau preferred not to receive that criticism again. But restricting how a creditor can set its wholesale credit rates is only one of the astounding ways the agencies have injected themselves into the dealer compensation practices of finance sources.

Each settlement with a bank or finance company adds momentum to the CFPB's campaign to reduce or eliminate dealer discretion in pricing auto financing. The settlements also begin to set an industry standard for ECOA compliance, which some denounce as regulation by enforcement settlements. The problem with this approach, of course, is that no court rules on whether the CFPB or the DOJ has a valid case - unlike litigated enforcement actions. The creditors settle for their own good reasons. Further, the settlements set, at best, a fuzzy industry standard. There are differences - big and small - among the orders. Can any serve as an acceptable model for another creditor's own program, or only the most recent one? And, unlike rulemaking, the other industry players do not get to weigh in on the terms or offer better ideas. The House of Representatives Financial Services Committee continues to raise serious concerns about the law and facts underpinning the CFPB's approach to fair lending enforcement in auto finance.

But the train keeps on rolling.

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

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

www.hudsoncook.com