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CHAIRWOMAN

United States House of Representatives
Committee on Financial Services
2129 Rayburn House Office Building
Washington, D.C. 20515

PATRICK MCHENRY, NC
RANKING MEMBER

April 26, 2019

Memorandum

To: Members, Committee on Financial Services

From: FSC Majority Staff

Subject: May 1, 2019, "Examining Discrimination in the Automobile Loan and Insurance Industries"

The Subcommittee on Oversight and Investigations will hold a hearing entitled "Examining Discrimination in the Automobile Loan and Insurance Industries," on Wednesday, May 1, 2019 at 10:00 a.m. in room 2128 of the Rayburn House Office Building. The witnesses for this one-panel hearing are:

- **John W. Van Alst**, Attorney, National Consumer Law Center; Director, Working Cars for Working Families, an NCLC project
- **Rachel J. Cross**, Policy Analyst, Frontier Group
- **Kristen Clarke,** President and Executive Director, Lawyers Committee for Civil Rights Under Law
- **Joshua Rivera**, Policy Advisor, University of Michigan, Poverty Solutions
- **James Lynch**, Chief Actuary, Vice President of Research and Education, Insurance Information Institute

Overview

Auto loan debt is the third largest category of household debt, after mortgages and student loans. Americans owe $1.26 trillion in auto loan debt, the equivalent of 5.5% of GDP.[1] Nearly all American households own at least one vehicle,[2] and most Americans must borrow money to purchase a car.[3] Auto borrowing varies by income, age, and state, with Texas borrowers having the highest average auto debt, over $6,500 per capita.[4] A February 2019 study by Frontier Group and U.S. PIRG Education Fund[5] identified several alarming trends in the market for auto finance, including repayment terms of six years and longer, buyers rolling over large unpaid car loan balances into loans for a replacement vehicle, and an increase in higher-cost subprime loans.

Most consumers finance the purchase of a car through either direct or indirect lending.[6] Borrowers

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[1] Federal Reserve Bank of New York, Center for Microeconomic Data, *Household Debt and Credit Report Q3 2018* (Nov. 2018); *id.*, *Quarterly Report on Household Debt and Credit* (Nov. 2015).
[2] U.S. Census Bureau, Selected Housing Characteristics (2015).
[3] 85% of all new cars are financed, while 53% of used car buyers rely on loans. These rates are up from 2009 levels, by 75% and 46% respectively. Experian Information Solutions, Inc., *State of Automotive Finance Market* at 12 (2017).
[4] *See* Appendix A, graphic of auto debt per capita by state.
[5] Frontier Group and U.S. PIRG Education Fund, *Driving Into Debt: The Hidden Costs of Risky Auto Loans to Consumers and Our Communities* (Feb. 2019) ("PIRG Report").
[6] National Fair Housing Alliance, *Discrimination When Buying A Car: How the Color of Your Skin Can Affect Your Car-Shopping Experience* at 6 (Jan. 2018) ("NFHA Report"). A third, less common financing option is known as "Buy Here,

can obtain auto loans directly from credit unions and banks that have no connection to an auto dealer. Buyers can also secure financing indirectly at the car dealership, which shares borrowers' financial data with depository and nonbank lenders who evaluate that information and decide whether to purchase the sales contract. When a lender chooses to purchase a contract, it determines the "buy rate," or the interest rate at which the lender is willing to purchase the contract from the dealer based on the credit worthiness of the buyer. Some indirect lenders allow dealers to charge a higher interest rate than the buy rate when they present the final interest rate to the consumer – commonly referred to as a "dealer markup." These dealer markups are unrelated to the credit risk of the borrower and yield additional compensation for the dealer, while increasing consumer costs, by billions of dollars according to one estimate.[7] Dealers who partner with indirect lenders are thus able to earn revenue through the price of the vehicle itself, interest-rate markups, and the sale of add-on products.

Federal Regulatory Framework

The Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") transferred consumer protection oversight and the enforcement of certain consumer protection laws to the Consumer Financial Protection Bureau ("CFPB" or "the Consumer Bureau").[8] One such law, the Equal Credit Opportunity Act ("ECOA"), prohibits creditors from discriminating against loan applicants in credit transactions on the basis of characteristics such as race, national origin, and sex.[9] Although §1029 of Dodd-Frank excluded auto dealers from the Consumer Bureau's direct oversight, the CFPB has used its statutory authority to oversee the indirect auto lending activity of depository and nonbank institutions that partner with auto dealers to provide financing to consumers.

In March 2013 the CFPB issued guidance[10] on indirect auto lending and the fair lending mandates of ECOA and its implementing rule, Regulation B. The guidance explained the circumstances under which depository and nonbank institutions offering auto loans through dealerships (indirect auto lenders) constitute creditors within the meaning of the ECOA. These circumstances include participating in the credit decision by, *e.g.*, evaluating an applicant and establishing a buy rate, and utilizing policies that allow dealers the discretion to mark up interest rates above the lender's buy rate. An indirect auto lender's markup and compensation policies may trigger liability under ECOA if they give rise to credit pricing disparities on a prohibited basis, such as race, national origin, or sex. After issuing this guidance, the CFPB brought four enforcement actions against lenders based on dealer markup policies that resulted in non-white borrowers paying higher auto loan interest rates.[11]

Pay Here" ("BHPH"), wherein the dealer underwrites and holds the loans with no involvement by an outside financial institution, typically with APRs above 20% and weekly loan payments.

[7] One study estimated that rate markups added $25.8 billion in interest over the life of borrowers' loans. Center for Responsible Lending, *Under the Hood: Auto Loan Interest Rate Hikes Inflate Consumer Costs & Loan Losses,* Apr. 2011.

[8] 12 U.S.C. § 5581(b).

[9] 15 U.S.C. §1691, *et seq*. The ECOA makes it illegal for a creditor to discriminate in any aspect of a credit transaction because of race, color, religion, national origin, sex, marital status, age, receipt of income from any public assistance program, or the exercise, in good faith, of a right under the Consumer Credit Protection Act

[10] CFPB Bulletin 2013-02, *Indirect Auto Lending and Compliance with the Equal Credit Opportunity Act* (Mar. 21, 2013).

[11] *See* Ally Financial, Inc., File No. 2013-CFPB-0010, Dec. 2013 (in the federal government's largest ever auto loan discrimination settlement, $18 million in penalties and $80 million in damages paid to 235,000 non-white borrowers charged higher interest rates because of Ally's discriminatory pricing); Toyota Motor Credit Corp., File No. 2016-CFPB-0020, Feb. 2016 ($21.9 million in restitution paid to thousands of non-white borrowers who paid higher interest rates than white borrowers, without regard to creditworthiness); Fifth Third Bank, File No. 2015-CFPB-0024, Sept. 2015 ($18 million paid to African-American and Hispanic borrowers overcharged as a result of Respondent's policy of allowing dealers to mark up interest rates above Respondent's established buy rate); American Honda Finance Corporation, File No. CFPB, 2015-CFPB-0014, July 2015 ($24 million in consumer restitution paid corrective action mandated to reduce or

Since Regulation B prohibits lenders from recording borrowers' race, sex, or ethnicity other than in a mortgage transaction, the CFPB used Bayesian-Improved Surname Geocoding, a statistics-based proxy methodology that combines publicly available geography- and surname-based information into a single proxy probability for race and ethnicity, to determine whether discriminatory practices or effects existed.[12] While that method has been criticized as potentially over inclusive,[13] similar proxy methodology has been used by the federal government to identify race/ethnicity for various purposes for years.[14]

In 2018 the House and Senate voted to repeal Bulletin 2013-02 pursuant to the Congressional Review Act. The President signed the measure in May 2018, repealing the guidance and affecting the ability of regulators to maintain fair, equitable, and nondiscriminatory access to credit for consumers in the auto lending marketplace.

Data on Discrimination in Auto Finance

Yale Law Professor Ian Ayres was the first to demonstrate that discretionary dealer markups on auto loans disproportionately affected non-white car buyers. In landmark 1991 and 1994 studies, he sent testers of various races to new car dealerships and found that dealers charged African-American males twice the markup of white males.[15] A larger study in 2003 examined 1.5 million GMAC loans made from 1999 to 2003 and found that African-American buyers were three times as likely as equally qualified white buyers to be charged a markup.[16] Thus, African-American borrowers paid more than $84 million in markups.

Between 2003 and 2007, the National Consumer Law Center ("NCLC") settled for more than $100 million several class actions[17] it filed against auto finance companies and banks that exposed racial disparities in markups paid by African-American and white consumers. Data from race-coded loans[18] analyzed by Professor Ayers showed larger and more frequent interest-rate markups charged to African Americans when compared to white consumers of equal creditworthiness.[19] Dealers were twice as likely to markup the loans of African Americans than those of comparable white borrowers. When African-American and similarly situated white borrowers both were charged markups, African-American borrowers paid significantly more.[20] The dealer markup limitations imposed in the settlement expired in 2012.

The lack of data collection necessary to fully uncover discriminatory practices in the auto finance

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eliminate dealer discretion over markups).

12 CFPB, *Using Publicly Available Information to Proxy for Unidentified Race and Ethnicity: A Methodology and Assessment* at 3 (Summer 2014).

13 Charles River Assoc. and Amer. Fin. Serv. Assoc., *Fair Lending: Implications for the Indirect Auto Finance Market* (2014); Repub. Staff, Comm. on Fin. Serv., *Unsafe at Any Bureaucracy: CFPB Junk Science and Indirect Auto Lending* (2015).

14 For example, the Departments of Justice and Health and Human Services have employed Bayesian methodology.

15 Ayres, Ian, *Fair Driving: Gender and Race Discrimination in Retail Car Negotiations*, 104 Harv. L. Rev. 817 (1991); *Further Evidence of Discrimination in New Car Negotiations and Estimates of Its Cause*, 94 Mich. L. Rev. 109 (1995).

16 Cohen, Mark A., *Report on Racial Impact of GMAC's Finance Charge Markup Policy* (Jan. 2003), available at www.researchgate.net/publication/247390713_Report_on_Racial_Impact_of_GMAC"s_Finance_Charge_Markup_Policy.

17 *See* http://www.nclc.org/litigation/case-index-closed-cases.html#auto (collecting cases).

18 NCLC hired an expert witness to match data on auto loans obtained in discovery with driver's license data from states that collected drivers' race.

19 *See*, *e.g.*, Ayers, Ian, Expert Report (June 30, 2004); *see also* Cohen, Mark A. *Imperfect Competition in Auto Lending: Subjective Markups, Racial Disparity, and Class Action Litigation* (Dec. 14, 2006).

20 For example, in Wisconsin, African-American Ford buyers paid an average $1,041 markup, while white buyers paid $156. *See* Appendix C, *Racial Disparities in Auto Loan Markups, State by State Data* (June 2015).

space presents a barrier to meaningful progress. While auto lenders have faced liability under ECOA, Regulation B prohibits them from asking about or documenting borrowers' race or ethnicity in any financial transaction other than a mortgage. Consequently, advocates have observed that auto financing lacks the transparency and scrutiny provided to mortgage lending even though it is a more common financial transaction.[21] In its 2019 report, the Frontier Group, a research organization and member of the Public Interest Network, also called on policy makers to prohibit discriminatory loan markups, address the conflicts of interest inherent in indirect auto lending, and expand options for responsible lending to low income Americans.[22]

Beyond interest rate markups, other dealer sales practices disparately impact non-white car buyers. In 2017 NCLC's research highlighted predatory practices used by dealers to drive up profits, including inconsistent, opaque pricing of often "mandatory" add-on products with questionable utility and value, such as service contracts and GAP (guaranteed asset protection) insurance.[23] NCLC found that these add-ons are inflated far above dealer cost and at far higher rates than vehicle markups. Many dealers engaged in pricing discrimination, charging Hispanics higher markups than non-Hispanics.[24] These abuses significantly harm consumers, due to higher monthly payments with no corresponding increase in vehicle value, higher loan to value ratios, greater negative equity, and more frequent default rates. For example, research by the Center for Responsible Lending ("CRL") showed that the likelihood of late payment was higher (14% versus 8%) where consumers were sold multiple add-on products as compared to the likelihood of late payment where no add-on products were purchased. CRL also found that African Americans and Latinos were nearly twice as likely to be sold multiple add-on products as white consumers. Notably, CRL found that people of color were charged higher interest rates than white buyers, even though only 22% of white car buyers negotiated their interest rate as compared with 39% of Latinos and 32% of African Americans who did so.[25]

In a 2018 study by National Fair Housing Alliance ("NFHA"),[26] eight pairs of testers visited dealerships to inquire about buying the same vehicle. NFHA utilized the same matched pair testing methodology that has been validated in the mortgage lending context, with one white and one similarly situated non-white counterpart in each test. The study showed that 62.5% of the time, non-white testers who were more qualified (*i.e.*, had higher incomes and credit scores) than white testers received costlier loans. The discrimination premium was significant: "Non-White testers who experienced discrimination would have paid an average of $2,663 more over the life of the loan than less-qualified White testers."[27]

Data on Discrimination in Auto Insurance

Auto insurers, regulated primarily at the state level, set rates using many factors, subject to applicable state law. Typically, they begin with a base rate, increasing or decreasing that rate based on

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21 NCLC, *Auto Add-Ons Add Up: How Dealer Discretion Drives Excessive, Arbitrary, and Discriminatory Pricing* (Oct. 2017) ("NCLC Report") at 20, 27 ("the policy does not prevent discrimination, but instead makes it difficult to determine if discrimination occurs. This Regulation B provision has an effect that is counter to the ECOA's purpose."); *see also* U.S. Government Accountability Office, Fair Lending: Race and Gender Data Are Limited for Nonmortgage Lending, GAO-08-698 (June 2008) (noting that requiring lenders to collect and report such data could assist in stopping discrimination).
22 PIRG Report at 7, 32-33.
23 NCLC Report.
24 *See* Appendix B, charts showing average service contract markups by state.
25 Center for Responsible Lending, *Non-Negotiable: Negotiation Doesn't Help African Americans and Latinos on Dealer-Financed Car Loans* at 16 (Jan. 2014).
26 NFHA Report, *supra* n. 6.
27 *Id.* At 5.

factors such as an insured's driving record, demographics, location, credit score, or other factors. The factors vary and depend on state law.[28] Recently California became the latest state to prohibit the use of gender in auto insurance pricing.[29]

In a 2017 study, the Consumer Federation of America ("CFA") found that most auto insurers charge middle-age women higher rates than men.[30] Data in ten U.S. cities showed that women aged 40 and 60 with perfect driving records paid higher rates than men. Research also shows racial discrimination in auto insurance rates.[31] A nationwide study by CFA found that a driver living in a predominantly African-American neighborhood can expect to pay auto insurance premiums that are an average of 70% more than those paid by similarly situated drivers living in areas where African Americans are in the minority, controlling for income and population density.[32] In a 2017 study of auto insurance in minority neighborhoods, ProPublica and Consumer Reports compared premiums and payouts in California, Texas, Illinois, and Missouri.[33] When comparing majority white neighborhoods and majority non-white neighborhoods, both with similar accident costs and risk profiles, customers of three large insurers paid an average of 30% more in premiums.

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[28] California, Hawaii, and Massachusetts have banned the use of credit scores and gender in rate setting; PA, NC, MT, and MI ban the use of gender, but not credit scores.

[29] California Dep't. of Insur., *Gender Non-Discrimination in Automobile Insurance Rating Regulation* (eff. Jan. 1, 2019).

[30] Consumer Federation of America, *Most Large Auto Insurers Charge 40 and 60-Year-Old Women Higher Rates Than Men* (Oct. 2017).

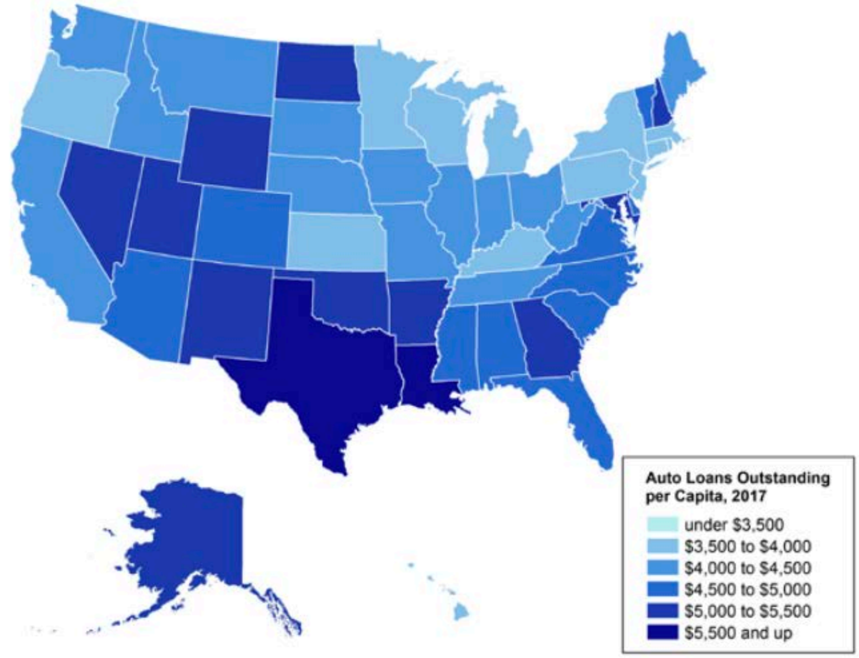
[31] State level studies have reached similar conclusions. *See, e.g.,* Texas Appleseed, *Out of Alignment: Women and Discrimination in the Texas Auto Insurance Market* (Oct. 2018); Coalition Protecting Auto No-Fault, *Comparing Socioeconomic Status and Auto Insurance Rates in Michigan* (Aug. 2017); Maryland Consumer Rights Coalition, *Taking the Low Road: How Auto Insurers Drive Up Rates for Women* (Jan. 2017).

[32] Consumer Federation of America, *High Price of Mandatory Auto Insurance in Predominately African American Communities* (Nov. 2015).

[33] ProPublica and Consumer Reports. *Minority Neighborhoods Pay Higher Car Insurance Premiums Than White Areas with the Same Risk* (Apr. 2017).

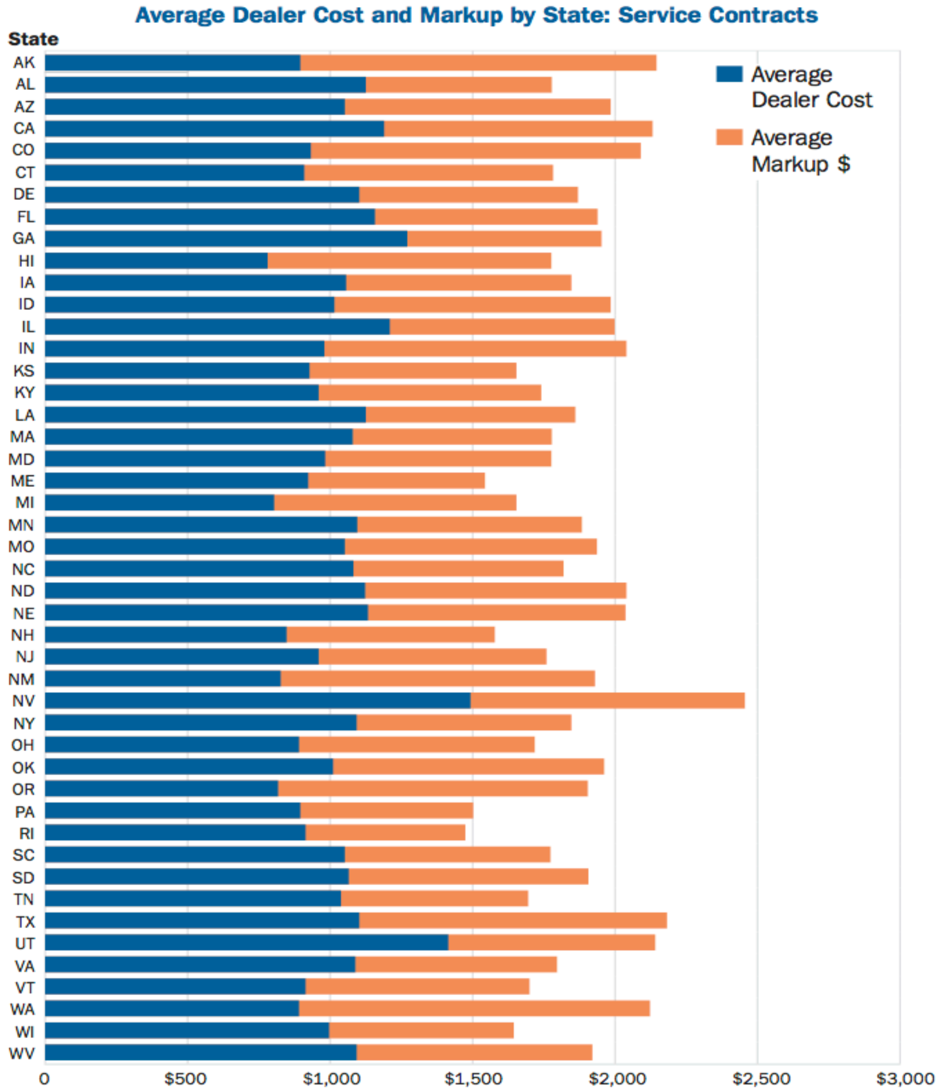
Appendix A

FIGURE ES-3. OUTSTANDING AUTO DEBT PER CAPITA BY STATE, 2017[15]



Source: Frontier Group and U.S. PIRG Education Fund, *Driving Into Debt: The Hidden Costs of Risky Auto Loans to Consumers and Our Communities* (Feb. 2019); Federal Reserve Bank of New York, Center for Macroeconomic Data, *State Level Household Debt Statistics 2003-2017* (Feb. 2018).

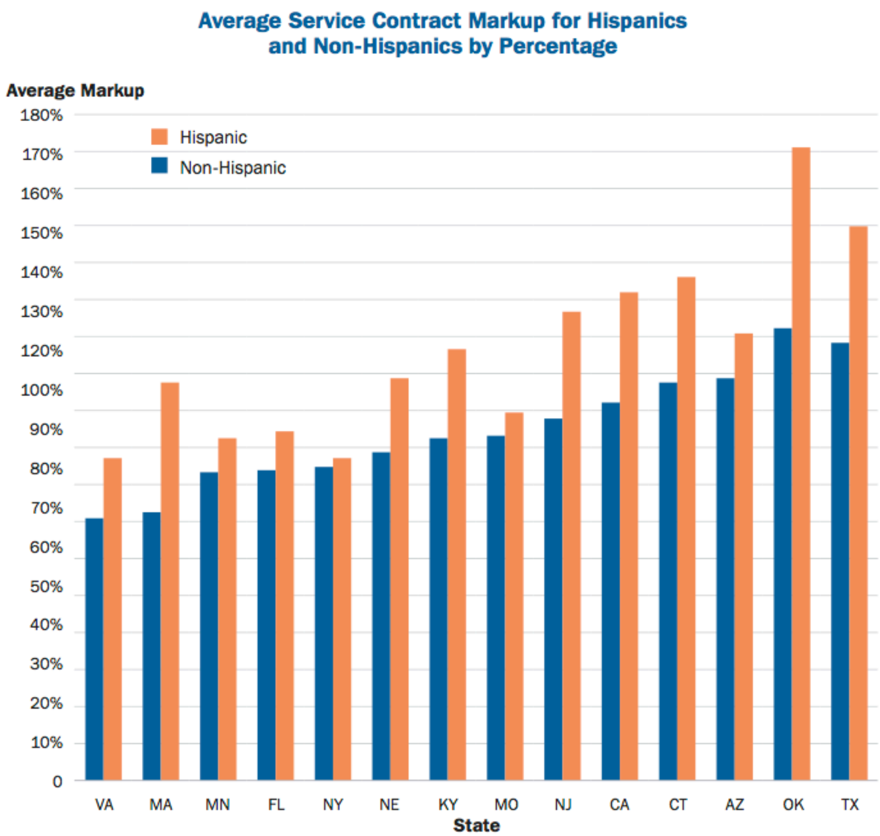
Appendix B



Source: National data set of one provider's add-on products sold in the U.S., 2012.

Note: Only shows states with 100 or more records.

Appendix B (continued)



Source: National data set of one provider's add-on products sold in the U.S., 2011.

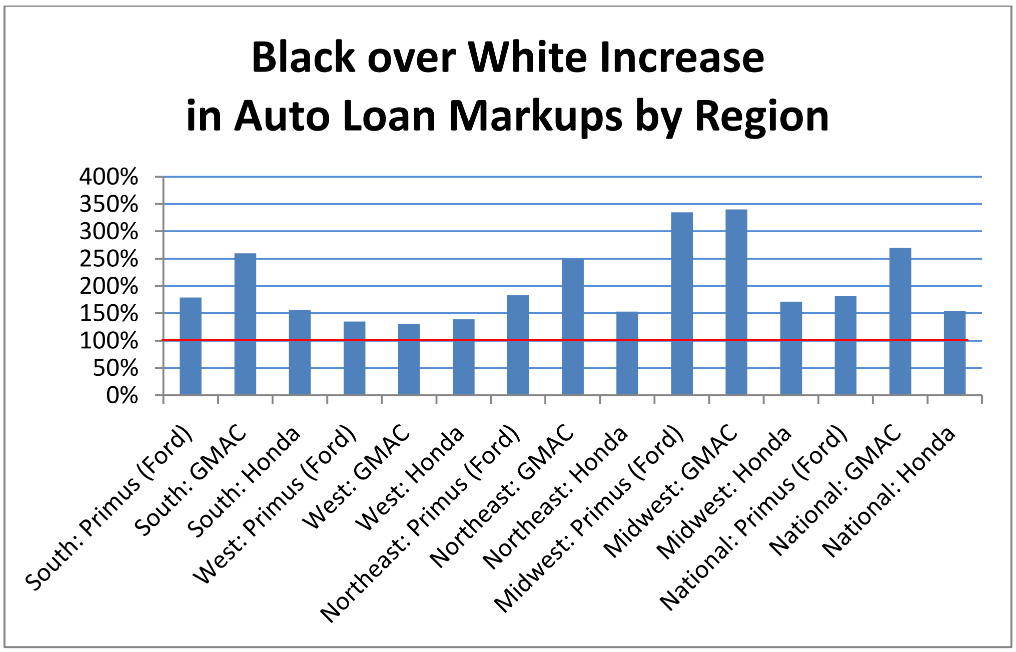
NATIONAL CONSUMER LAW CENTER®

Racial Disparities in Auto Loan Markups State-by-State Data

June 2015

Data from the late 1990s to early 2000s obtained in nationwide cases against the major auto lenders, brought by the National Consumer Law Center and co-counsel, showed **widespread racial disparities, unrelated to credit risk, in the markups added by auto dealers to auto loan rates.**

In practices similar to today, the auto dealers had discretion whether and how much to markup rates already priced for credit risk by the auto lenders. **Actual data from millions of race-coded loans showed that dealers were more likely to markup the loans of African Americans or to impose higher markups.** The data matched racial information contained in drivers' license records with loans to individual borrowers.[1] The powerful data convinced the courts that "the plaintiffs have proved their case"[2] that permitting discretionary markups led to unacceptable racially disparate impacts. The cases settled with limits on auto dealer markups, but the limits all expired by 2012.



Statistically significant racial disparities were found **in every state with sufficient data and in every region of the country**. Disparities were **also found for Hispanics** on a national level,[3] but Hispanic origin was not coded on enough loans to analyze state by state.

Auto Dealer Loan Rate Markups by Race and State

State	Lender	Black	White	Black over White Increase
Alabama	Primus (Ford)	$965	$616	157%
	GMAC	$836	$276	303%
	Honda	$792	$553	143%

* *Note:* In May 2010, the entity referred to in this Appendix as "GMAC" changed its general corporate identity to Ally Financial, Inc. *See* Ally Financial press release, *Ally Financial Statement on New Corporate Brand* (May 10, 2010) http://media.ally.com/index.php?s=43&item=401.

Arkansas	Primus (Ford)	$108	$114	95% [4]
	Honda	$479	$395	121%
California	Primus (Ford)	$742	$553	134%
	GMAC	$249	$192	130%
	Honda	$892	$626	142%
Colorado	GMAC	$479	$232	206%
Connecticut	GMAC	$480	$172	279%
Dist. of Columbia	GMAC	$857	$255	336%
Delaware	GMAC	$376	$103	365%
Florida	Primus (Ford)	$900	$524	172%
	GMAC	$632	$269	235%
	Honda	$1,063	$669	159%
Georgia	GMAC	$626	$288	217%
Iowa	Primus (Ford)	$1,054	$232	454%
	GMAC	$522	$127	411%
	Honda	$460	$409	112%
Illinois	GMAC	$405	$156	260%
Indiana	GMAC	$281	$152	185%
Kansas	GMAC	$315	$226	139%
Kentucky	GMAC	$298	$158	189%
Louisiana	Primus (Ford)	$810	$378	214%
	GMAC	$803	$290	277%
	Honda	$1,285	$731	176%
Massachusetts	GMAC	$610	$286	213%
Maryland	Primus (Ford)	$1,159	$452	256%
	GMAC	$838	$329	255%
	Honda	$1,245	$724	172%
Minnesota	GMAC	$212	$145	146%
Mississippi	Primus (Ford)	$858	$493	174%
	GMAC	$576	$252	229%
	Honda	$789	$583	135%
Missouri	GMAC	$429	$233	184%
North Carolina	Primus (Ford)	$643	$273	236%
	GMAC	$601	$261	230%
	Honda	$958	$652	147%
Nebraska	Primus (Ford)	$496	$154	322%
	GMAC	$321	$74	434%
New Jersey	GMAC	$488	$203	240%
New York	GMAC	$510	$164	311%
Oklahoma	Primus (Ford)	$1,005	$734	137%
	GMAC	$488	$216	226%
	Honda	$1,056	$624	169%
Pennsylvania	GMAC	$339	$173	196%
South	Primus (Ford)	$812	$405	200%
	GMAC	$598	$245	244%

Carolina	Honda	$969	$641	151%
Tennessee	Primus (Ford)	$1,046	$409	256%
	GMAC	$929	$317	293%
	Honda	$1,102	$712	155%
Texas	Primus (Ford)	$901	$582	155%
	GMAC	$564	$272	207%
	Honda	$1,272	$860	148%
Virginia	GMAC	$602	$197	306%
Washington	GMAC	$368	$184	200%
Wisconsin	Primus (Ford)	$1,041	$156	667%
	GMAC	$714	$144	496%
	Honda	$1,045	$477	219%
Wyoming	GMAC	$309	$116	266%

More information on NCLC's auto finance discrimination cases is available at:
http://www.nclc.org/litigation/case-index-closed-cases.html#auto

For more information, contact National Consumer Law Center attorney John Van Alst at (617) 542-8010 or jvanalst@nclc.org.

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[1] Although not every state identifies race in its drivers' license records, data from the states that do could also be used in other states when the borrower moved.
[2] Borlay v. Primus Automotive Financial, M.D. Tenn., No. 02-CV-382 (Mar. 16, 2005). Primus Automotive Financial is a subsidiary of Ford Motor Credit Corp.
[3] For loans assigned to American Honda Finance Corp., the average national auto dealer markup for Hispanics was $858 and for whites it was $667. For loans assigned to Primus, the average national Hispanic markup was $715 and the average white markup was $464.
[4] Data for Primus for Arkansas were not statistically significant. In addition, constitutional usury limits in Arkansas constrained excessive markups.