PRIVILEGED AND CONFIDENTIAL

November 19, 2014

DECISION MEMORANDUM FOR THE DIRECTOR

FROM: Jane Peterson, Rebecca Gelfond, and Patrice Ficklin, Office of Fair Lending

SUBJECT: Authorization to Seek a Settlement with or Commence Litigation Against American Honda Finance Corporation, CFPB Enforcement Matter # 2014-1257-02, [redacted], CFPB Enforcement Matter [redacted], and [redacted], CFPB Enforcement Matter [redacted]

RECOMMENDATION:

We recommend that you authorize the Offices of Fair Lending and Enforcement (1) to settle with American Honda Finance Corporation, [redacted], and [redacted] under the parameters described in Section V below and the attached Term Sheets; (2) if settlement negotiations are successful, to file complaints and consent orders in federal court or administrative stipulations and consents effectuating the settlements; and (3) if settlement negotiations are unsuccessful, to commence an enforcement action, either administratively or in federal court, consistent with the attached complaints.[1] We have also recommended that the Bureau refer this matter to the Department of Justice, which is proceeding to obtain authorization to file suit against these entities as well.

✓ RC Approve __________ Disapprove __________ Discuss

[1] In requesting authorization to file the attached complaints, we also seek authority to fix minor typographical errors or to make other non-substantive changes to the complaints before filing. Additionally, because we are working jointly with the Department of Justice ("DOJ"), there will likely be additional changes to the complaints.

Furthermore, because the specific terms of any consent order will be subject to negotiation and ongoing modification, we are not attaching draft consent orders to this memorandum. However, as settlement negotiations proceed, will we discuss proposed orders with the Legal Division before we submit them to you.

I. OVERVIEW

The Office of Enforcement and the Office of Fair Lending and Equal Opportunity ("Bureau staff") seek authority to settle with, or in the alternative commence litigation against, American Honda Finance Corporation ("Honda"), [redacted], and [redacted] for alleged violations of the Equal Credit Opportunity Act ("ECOA"), 15 U.S.C. §§ 1691-1691f, and its implementing regulation, Regulation B, 12 C.F.R. pt. 1002. We understand that the Department of Justice ("DOJ") is simultaneously seeking authorization to file a complaint against these three entities.[2]

Bureau staff have concluded that from January 1, 2011 to December 31, 2013, Honda, [redacted], and [redacted] have violated the ECOA by charging borrowers higher dealer markups on their automobile loans on the basis of race and national origin. These disparities resulted from a combination of each of these institution's policies and practices of permitting dealers to mark up interest rates, compensating dealers from the interest revenue from those markups, and failing to implement or maintain adequate internal controls and monitoring to prevent the discrimination from occurring.

Specifically, statistical analyses conducted by the Bureau's expert, BLDS, identified the following disparities during the three-year time period from January 1, 2011 to December 31, 2013:

Honda:

- African-American[3] borrowers paid an average of 36 basis points more in dealer markups than similarly situated non-Hispanic white borrowers on non-subvented loans;
- Hispanic borrowers paid an average of 28 basis points more in dealer markups than similarly situated non-Hispanic white borrowers on non-subvented loans; and

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[2] In the event these matters do not settle and litigation is required, the Offices of Fair Lending and Enforcement think it unlikely that it could litigate against all three of these parties without substantial disruption to other enforcement priorities. We intend to revisit which of the parties the Bureau should sue should litigation against all three entities be anticipated.

[3] As used in this document, "African American" includes "Black or African American" and "Hispanic" includes "Hispanic or Latino," as defined by the Office of Management and Budget in *Revisions to the Standards for the Classification of Federal Data on Race and Ethnicity* (Oct. 30, 1997), available at http://www.whitehouse.gov/omb/fedreg_1997standards.

- Asian and/or Pacific Islander borrowers paid an average of 25 basis points more in dealer markups than similarly situated non-Hispanic white borrowers on non-subvented loans.

[redacted]:

- African-American borrowers paid an average of 27 basis points more in dealer markups than similarly situated non-Hispanic white borrowers on non-subvented loans;
- Asian and/or Pacific Islander borrowers paid an average of 18 basis points more in dealer markups than similarly situated non-Hispanic white borrowers on non-subvented loans; and
- African-American borrowers paid an average of 25 basis points more in dealer markups than similarly situated non-Hispanic white borrowers on subvented [redacted] loans.

[redacted]:

- African-American borrowers paid an average of 23 basis points more in dealer markups than similarly situated non-Hispanic white borrowers on non-subvented loans; and
- Asian and/or Pacific Islander borrowers paid an average of 14 basis points more in dealer markups than similarly situated non-Hispanic white borrowers on non-subvented loans.

The disparities identified with respect to Honda are expected to cost 164,641 harmed African-American, Hispanic, and Asian and/or Pacific Islander borrowers who paid higher markups than the non-Hispanic white average markup more than $53.5 million over the full life of their loans. The disparities identified with respect to [redacted] are expected to cost 127,285 African-American and Asian and/or Pacific Islander borrowers who paid higher markups than the non-Hispanic white average markup more than $41.3 million over the full life of their loans. The disparities identified with respect to [redacted] are expected to cost 74,405 African-American and Asian and/or Pacific Islander borrowers who paid higher markups than the non-Hispanic white average more than $21.8 million over the full life of their loans.

Past cases have demonstrated that pricing disparities that result from granting automobile dealers discretion to mark up interest rates can provide the basis for actionable claims of discrimination in violation of the ECOA.[4] These are the first

[4] *See Jones v. Ford Motor Credit Co.*, 2002 WL 88431 (S.D.N.Y. Jan. 22, 2002) (denying a motion to dismiss); *Osborne v. Bank of America Nat'l Ass'n*, 234 F. Supp. 2d

nonbank cases, following the settlement in the *Ally* matter,[5] in which the Bureau seeks to enforce violations of the ECOA for discriminatory dealer markups in the indirect automobile lending industry. As such, it will send an important message to the indirect auto lending industry about the Bureau's continuing commitment to ensuring compliance with the ECOA and addressing the consumer harm associated with dealer markup and leveling the industry playing field, by including within the scope of the Bureau's enforcement activity both banks and nonbanks.

The final settlement value of each of these matters will vary based on the strength of several defenses that each institution will likely raise.

We request authority to settle Honda in the range of *$17-$135* million.[6] As discussed more fully below, that range consists of the following:

(1) Damages to harmed borrowers in the range of *$17-$105* million, to address the direct monetary and indirect monetary and non-monetary harms they suffered, including:

a. Direct monetary damages in the range of *$13-$54* million (paid as money or as a note rate reduction) for loans originated between January 1, 2011 and December 31, 2013;

b. Direct monetary damages in the range of *$4-18* million (paid as money or as a note rate reduction) for loans originated between January 1, 2014 and December 31, 2014;

c. Indirect damages for harmed consumers who borrowed from Honda between January 1, 2011 and December 31, 2013, up to *$25* million;

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804 (M.D. Tenn. 2002) (denying motion to dismiss); *Wise* ex rel. *Estate of Wilson v. Union Acceptance Corp.*, 2002 WL 31730920 (S.D. Ind. Nov. 19, 2002) (denying motion to dismiss); *Coleman v. General Motors Acceptance Corp.*, 220 F.R.D. 64 (M.D. Tenn. 2004) (granting class certification).

[5] *In the Matter of Ally Financial*, No. 2013-CFPB-0010 (Dec. 20, 2013).

[6] While we request authorization up to $135 million for negotiation purposes, we anticipate a negotiated range to likely fall between $25-40 million for damages, particularly in light of likely prepayment data. With respect to civil money penalties, unless we forgo a penalty based on adoption of an alternative dealer compensation structure, we anticipate a negotiated range to likely fall between $8-$18 million, commensurate with the penalties obtained in Ally based upon the amount of consumer harm.

d. Indirect damages for harmed consumers who borrowed from Honda between January 1, 2014 and December 31, 2014, up to *$8* million; and

(2) Proportional civil money penalties likely to be in the range of *$0-30* million.

We request authority to settle [redacted] in the range of *$14-$102* million.[7] As discussed more fully below, that range consists of the following:

(1) Damages to harmed borrowers in the range of *$14-$82* million, to address the direct monetary and indirect monetary and non-monetary harms they suffered, including:

a. Direct monetary damages in the range of *$10-$42* million (paid as money or as a note rate reduction) for loans originated between January 1, 2011 and December 31, 2013;

b. Direct monetary damages in the range of *$4-$14* million (paid as money or as a note rate reduction) for loans originated between January 1, 2014 and December 31, 2014;

c. Indirect damages for harmed consumers who borrowed from [redacted] between January 1, 2011 and December 31, 2013, up to *$19* million;

d. Indirect damages for harmed consumers who borrowed from [redacted] between January 1, 2014 and December 31, 2014, up to *$7* million; and

(2) Proportional civil money penalties in the range of *$0-20* million based upon [redacted] significant cooperation and development of a fair lending compliance management system, including implementation of consumer remuneration, since being notified of the investigation.

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[7] While we request authorization up to *$102* million for negotiation purposes, we anticipate a negotiated range to likely fall between *$20-30* million for damages, particularly in light of likely prepayment data. With respect to civil money penalties, unless we forgo a penalty based on adoption of an alternative dealer compensation structure, we anticipate a negotiated range to likely fall between *$5-$10* million, commensurate with the penalties obtained in Ally based upon the amount of consumer harm in this case, but giving effect to [redacted] significant cooperation and development of a fair lending compliance program.

We request authority to settle █████ in the range of *\$8-\$75* million.[8] As discussed more fully below, that range consists of the following:

(1) Damages to harmed borrowers in the range of *\$8-\$45* million, to address the direct monetary and indirect monetary and non-monetary harms they suffered, including:

a. Direct monetary damages in the range of *\$6-\$22* million (paid as money or as a note rate reduction) for loans originated between January 1, 2011 and December 31, 2013;

b. Direct monetary damages in the range of *\$2-\$8* million (paid as money or as a note rate reduction) for loans originated between January 1, 2014 and December 31, 2014;

c. Indirect damages for harmed consumers who borrowed from █████ between January 1, 2011 and December 31, 2013, up to *\$11* million;

d. Indirect damages for harmed consumers who borrowed from █████ between January 1, 2014 and December 31, 2014, up to *\$4* million; and

(2) Proportional civil money penalties likely to be in the range of *\$0-\$30* million.

We also seek authority to negotiate injunctive relief requiring Honda, █████, and █████ to (1) adopt substantial enhancements to their dealer markup monitoring compliance program including paying remediation for any markup disparities identified by the program through the term of the order, (2) implement a 100 basis points (bps) cap on dealer discretion to mark up buy rates on loans with terms of 60 or fewer months (75 bps cap on dealer discretion to mark up buy rates on loans with terms of 61 or more months); or (3) implement an alternative nondiscretionary dealer compensation structure.

[8] While we request authorization up to *\$75* million for negotiation purposes, we anticipate a negotiated range to likely fall between *\$10-16* million for damages, particularly in light of likely prepayment data. With respect to civil money penalties, unless we forgo a penalty based on adoption of an alternative dealer compensation structure, we anticipate a negotiated range to likely fall between *\$5-\$15* million, commensurate with the penalties obtained in Ally based upon the amount of consumer harm.

II. FACTUAL BACKGROUND

A. Proposed Defendants: Honda, and

Honda is a wholly-owned subsidiary of American Honda Motor and serves both prime and subprime markets. Honda holds 3.55% of overall auto loan market share based on origination units, making it the seventh largest auto lender overall. It is the third largest captive auto finance company. Honda was also involved in prior litigation involving allegations of unlawful discrimination.[9] For the two-year period 2011-2012, Honda originated 1,230,700 indirect automobile loans of which 404,679 were non-subvented and 826,021 were subvented loans. Honda originated an additional 233,098 non-subvented loans in 2013.

It holds roughly of overall auto loan market share based on origination units, making it .[10] In 2011-2013, originated indirect automobile loans, of which are non-subvented and are subvented.

holds roughly of overall auto loan market share based on origination units, making it captive lender and , with percent in loan growth during 2013. .[11] In 2011-2013, originated indirect automobile loans, of which are non-subvented and are subvented.

B. Honda, , and Relevant Dealer Markup and Compensation Policies

In their indirect automobile lending businesses, Honda, , and purchase loans from their dealers at a specified "buy rate," which Honda, and

[9] *Willis v. Am. Honda Fin. Corp.*, Class Action No. 03-02-0490, (M.D. Tenn. Jan. 21, 2005), *available at* http://www.nclc.org/images/pdf/litigation/closed/ahfc_settlement-agreement.pdf.

[10]

[11]

███ determine using similar proprietary pricing models. Honda, ███, and ███ also will purchase retail installment contracts that the dealer, in its discretion, has priced higher than the buy rate, subject to certain limitations set by Honda, ███, and ███. The difference between the buy rate and the contract rate is known as the "dealer markup." Honda, ███, and ███ each then ███. In general, Honda, ███, and ███ each capped the dealer markup based upon certain criteria and each differed in the availability of dealer markup with respect to subvented transactions:

- With respect to non-subvented transactions, Honda allowed loans with contracts having less than ███ scheduled payments to be marked up ███ bps and loans with more than ███ scheduled payments to be marked up to ███ bps. Honda ███ with respect to subvented transactions, which make up about ███ of its loans.

- With respect to non-subvented transactions, ███ allowed loans for ███ months or less to be marked up ███ bps, loans of ███ ███ ███ months to be marked up 200 bps, and loans 72 to 84 months to be marked up ███ bps. With one notable exception, ███ subvented transactions, which make up about ███ of its loans. However, ███ allowed ███ vehicles with subvented rates to be marked up ███ bps; these loans account for about ███ of ███ subvented transactions.

- During the review period, with respect to non-subvented transactions, ███ generally allowed loans with contracts having ███ scheduled payments or less to be marked up ███ bps and loans with more than ███ scheduled payments to be marked up ███ bps.[12] With respect to non-subvented transactions, ███ also had ███, which capped markup on loans for ███ at ███ bps. ███ had only a limited number of subvented loans that allowed dealer markup discretion. ███ subvented loans. Prior to ███ ███ ███ subvented used vehicle loans; after ███ ███ permitted up to a ███ bps markup on used vehicle subvented loans in those limited instances in which the used vehicle subvented rates were not advertised to consumers, which was only approximately ███ transactions.

As discussed more below, Honda, ███, and ███ discretionary markup and compensation policies and lack of adequate monitoring and controls caused the pricing disparities discovered during the review.

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[12] In ███ ███ outside of the relevant review period, ███ lowered the caps for its non-subvented transactions across all contract terms to ███ bps.

C. Investigation History and Background

On or around April 25, 2013, the Bureau and the DOJ commenced joint investigations of Honda and [redacted]. On or around October 29, 2013, the Bureau and the DOJ also commenced an investigation of [redacted]. The investigations focused on whether these institutions unlawfully charged higher interest rates to consumer auto loan borrowers on the basis of race and/or national origin through discretionary pricing, including allowing dealer markups. The investigation covered transactions from January 1, 2011 to December 31, 2013.

The Bureau and DOJ sent joint information requests to Honda, [redacted], and [redacted] requesting information regarding their business policies and practices and data from their indirect auto lending business covering the period from January 1, 2011 through December 31, 2012. After reviewing the materials they provided and conducting preliminary data analysis, the Bureau and DOJ sent follow-up requests for information seeking clarification of certain information and additional data covering the period from January 1, 2013 through December 31, 2013. The Bureau's expert, BLDS, analyzed these institutions' auto loan transactions that allowed for discretionary dealer markups and identified dealer markup disparities.

The Office of Fair Lending formally communicated its preliminary findings to Honda and [redacted] by letter on November 7, 2014. The letters set forth the markup disparities and outlined the Bureau's analytical methodology. It also informed Honda and [redacted] of the possibilities of public enforcement action.

III. LEGAL ANALYSIS

The ECOA and Regulation B prohibit discrimination on the basis of, *inter alia*, race and national origin in "any aspect of a credit transaction."[13] A violation of the ECOA may be proven through (1) overt evidence of discrimination, (2) evidence of disparate treatment, or (3) evidence of disparate impact.[14] While disparate treatment is a possible method to establish an ECOA violation in a discriminatory dealer markup matter, Bureau staff believe that, based on current information, the strongest case to prove Honda, [redacted], and [redacted] violations of the ECOA can be made under the disparate impact doctrine.[15]

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[13] 15 U.S.C. § 1691(a)(1); 12 C.F.R. § 1002.4(a).

[14] *See* CFPB Bulletin 2012-04, *Lending Discrimination* (Apr. 18, 2012), available at http://files.consumerfinance.gov/f/201404_cfpb_bulletin_lending_discrimination.pdf ("Lending Discrimination").

[15] While Bureau staff do not anticipate negotiating a settlement with defendants or filing a complaint against defendants that expressly identifies the available theories of discrimination under the ECOA, Bureau staff note that a claim under the disparate treatment doctrine may also be available. At this point in the Honda, [redacted], and [redacted] investigations, the evidence of discrimination on the basis of race and national origin is

Regulation B, which implements the ECOA, specifies that the disparate impact doctrine is applicable under the ECOA. Specifically, Regulation B states that "[t]he legislative history of the Act indicates that the Congress intended an 'effects test' concept, as outlined in the employment field by the Supreme Court in the cases of *Griggs v. Duke Power Co.*, 401 U.S. 424 (1971), and *Albemarle Paper Co. v. Moody*, 422 U.S. 405 (1975), to be applicable to a creditor's determination of creditworthiness."[16]

As set forth in the Commentary to Regulation B, the ECOA prohibits a "creditor practice that is discriminatory in effect because it has a disproportionately negative impact on a prohibited basis, even though the creditor has no intent to discriminate and the practice appears neutral on its face, unless the creditor practice meets a legitimate business need that cannot reasonably be achieved as well by means that are less disparate in their impact."[17] To demonstrate a prima facie case of disparate impact liability, the Bureau must (1) identify a specific, facially neutral practice or policy used by the defendant; and (2) demonstrate, through statistical evidence, that the practice or policy has caused an adverse effect on the protected group.[18] The burden then shifts to the defendant to prove a legitimate business need for the practice or policy.[19] But the

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strictly statistical, however, and thus better suited to the disparate impact doctrine. *Compare Int'l Brotherhood of Teamsters v. U.S.*, 431 U.S. 324, 339-40 & n.20 (1977); *Hazelwood Sch. Dist. v. United States*, 433 U.S. 299, 307–08 (1977) (gross statistical disparities may, in a proper case, constitute prima facie proof of a pattern or practice of disparate treatment); *with Gay v. Waiters' & Dairy Lunchmen's Union, Local No. 30*, 694 F.2d 531, 552-53 (9th Cir. 1982) (noting that "[i]n order to establish a prima facie case of disparate treatment based solely on statistical evidence, the plaintiff must produce statistics showing 'a clear pattern, unexplainable on grounds other than race'" and cautioning that the strongest inference of intentional discrimination is one in which the statistical evidence is bolstered by other circumstantial evidence because "statistics demonstrating that chance is not the more likely explanation are *not* by themselves sufficient to demonstrate that race *is* the more likely explanation") (internal citations omitted). Should the matters proceed to litigation, consistent with the complaints, which include sufficient allegations to support claims under both disparate treatment and disparate impact, Bureau staff anticipates seeking additional discovery to support a disparate treatment claim.

[16] 12 C.F.R. § 1002.6(a).

[17] 12 C.F.R. pt. 1002 Supp. I § 1002.6(a)-(2).

[18] *See Albemarle Paper Co. v. Moody*, 422 U.S. 405, 425 (1975); *Griggs v. Duke Power Co.*, 401 U.S. 424, 431-32 (1971).

[19] *See Griggs*, 401 U.S. at 431-32; 12 C.F.R. § 1002.6(a) (noting that legislative history of the ECOA indicates that the disparate impact doctrine as outlined in *Griggs* and *Albemarle* applies to ECOA). *But see Wards Cove Packing v. Antonio*, 490 U.S. 642 (applying *Watson v. Fort Worth Bank and Trust*, 487 U.S. 977, 994 (1988)), to ECOA disparate impact claim and hence requiring the defendant only to meet a burden of

plaintiff can still prevail if there is a less discriminatory alternative that meets the business need.[20] The Bureau has affirmed that in enforcing the ECOA, it will utilize the disparate impact doctrine as appropriate.[21]

A. *Honda, [redacted], and [redacted] Employed Specific, Facially Neutral Policies That Have a Disparate Impact: The Discretionary Dealer Markup and Compensation Policies with Inadequate Internal Controls, Monitoring, and Remedial Actions*

1. Honda, [redacted], and [redacted] Discretionary Dealer Markup and Compensation Policies Caused a Statistically Significant Adverse Effect on African-American, Hispanic and Asian and/or Pacific Islander Borrowers

As described above, Honda, [redacted] and [redacted] each maintain a specific policy and practice that provides dealers discretion to mark up borrowers' interest rates above each institution's established buy rates, and compensates dealers for those markups. In establishing disparate impact liability, courts have long recognized that statistics, when properly analyzed, can support a showing of disparate impact on a prohibited basis.[22] In the context of dealer markup policies, courts have held that plaintiffs, for purposes of establishing a prima facie case, must provide "'statistical evidence of a kind and degree sufficient to show that the practice in question has caused' the assessment of the higher finance charge markup because of their membership in a protected group."[23] In this case, statistical analysis demonstrates that Honda, [redacted] and [redacted] discretionary markup and compensation policies disproportionately and adversely affected African-American, Hispanic, and Asian and/or Pacific Islander borrowers. This conclusion is based on a comprehensive two-part statistical analysis of each captive's indirect auto loan data and policies and procedures.

Section 1002.5(b) of Regulation B generally prohibits lenders from requesting information about the applicant's race and national origin for credit transactions that are not for the purpose of purchasing or refinancing the borrower's principal dwelling

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production rather than burden of persuasion); *Miller v. Countrywide Bank, N.A.*, 71 F.Supp.2d 251, 259 n.16 (D. Mass. 2008) (apply *Wards Cove* in an ECOA matter and noting that legislation had modified *Wards Cove* in the Title VII context, but that the case continues to apply in non-Title VII disparate impact cases).

[20] *See Albemarle,* 422 U.S. at 425.

[21] *See* CFPB Bulletin 2012-04 (Fair Lending) (Apr. 18, 2012).

[22] *See generally Int'l Brotherhood of Teamsters v. U.S.,* 431 U.S. 324, 340 n.20 (1977) (noting that statistics may be the "only available avenue of proof" in disparate impact cases) (citations and internal quotation marks omitted).

[23] *Coleman,* 196 F.R.D. at 324 (quoting *Watson v. Fort Worth Bank and Trust,* 487 U.S. 977, 994 (1988)).

and secured by that dwelling. Consistent with this rule, the indirect auto loan datasets provided by Honda, , and did not contain information on the applicants' race or ethnicity.

In order to conduct the statistical analyses, the Bureau's expert, BLDS, used a proxy methodology for estimating race and national origin for applicants based on reported address information and surname. Reported addresses for applicants were mapped into census tracts and matched to 2010 Census information on race and ethnicity. In addition, applicant surnames were matched to a list of surnames from the 2000 Census, which reports counts by race and ethnicity for every surname that appears over 100 times. Using the combination of probabilities based on geography and surname, the methodology assigned each applicant a probability of being a particular race and ethnicity (*e.g.*, 80% African American; 15% Hispanic; and 5% non-Hispanic white).[24]

BLDS then conducted an analysis of whether Honda, , and dealer markup and compensation policies resulted in disparities.

- The auto loan datasets provided by Honda contained non-subvented auto loan contracts that were funded by Honda during the three-year period from January 1, 2011 through December 31, 2013. After excluding loans that could not be proxied for race and national origin,[25] booked loans were included in the analysis sample.

- The auto loan datasets provided by contained non-subvented auto loan contracts that were funded by during the three-year period from January 1, 2011 through December 31, 2013. After excluding loans that could not be proxied for race and national origin,[26]

[24] Geography- and surname-based probabilities are combined using the methodology described in CFPB, *Using Publicly Available Information to Proxy for Unidentified Race and Ethnicity: A Methodology and Assessment* (Sept. 17, 2014), *available at* http://www.consumerfinance.gov/reports/using-publicly-available-information-to-proxy-for-unidentified-race-and-ethnicity/.

[25] BLDS excluded loans from the Honda analysis because there was insufficient proxy information, *i.e.*, some loans did not have a street address or a zip code and some did not have surname probability. The 2000 Census only reports race and ethnicity data for surnames that appear at least 100 times.

[26] BLDS excluded non-subvented loans from the analysis because there was insufficient proxy information, *i.e.*, some loans did not have a street address or a zip code and some did not have surname probability. The 2000 Census only reports race and ethnicity data for surnames that appear at least 100 times.

booked non-subvented loans were included in the analysis. Because only allowed discretionary dealer markup as to its subvented transactions, the Bureau limited its subvented loan analysis to these loans funded by during the three-year period from January 1, 2011 through December 31, 2013.[27]

- The auto loan datasets provided by contained non-subvented auto loan contracts that were funded by during the three-year period from January 1, 2011 through December 31, 2013.[28] After excluding loans that could not be proxied for race and national origin,[29] booked non-subvented loans were included in the analysis sample.

BLDS specifically analyzed the dealer markup, namely the *difference* between the contract rate and the buy rate. Given the fact that Honda, , and buy rate on any given transaction already accounted for characteristics associated with the borrower's creditworthiness, the characteristics of the vehicle, and the timing, location, and structure of the deal, such factors were not included as controls in the analysis, which focused on dealer markups. This analysis identified the following disparities and direct borrower harm based upon expected overpayment over the full life of the loan:

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[27] The subvented loans contain only loans for which BLDS was able to proxy.

[28] Due to the limited number of subvented loans for which a markup was permitted and data limitations that precluded us from identifying those particular loans, the Bureau did not analyze subvented loans. Therefore, subvented loans are not included in the Bureau's claims with respect to .

[29] BLDS excluded loans from the analysis because there was insufficient proxy information, *i.e.*, some loans did not have a street address or a zip code and some did not have surname probability.

Honda – Estimated Disparities and Direct Consumer Damages for Non-subvented Loans
Period of Review: January 1, 2011 to December 31, 2013

Prohibited Basis Group	Number of Affected Prohibited Basis Borrowers	Markup Disparity	Total Overpayment	Number of Harmed Prohibited Basis Borrowers[30]	Overpayment per Harmed Prohibited Basis Borrower
African Americans	68,050	36 basis points	$18.4 million	44,061	$417
Hispanics	130,341	28 basis points	$26.2 million	85,257	$307
Asian and/or Pacific Islanders	55,272	25 basis points	$8.9 million	35,323	$252
		TOTAL:	**$53.5 million**	**Average:**	**$325**

[30] This column shows the estimated numbers of African-American, Hispanic, and Asian and/or Pacific Islander borrowers who paid more than the non-Hispanic white average markup. Note that, consistent with the approach in *Ally*, the "Markup Disparity" and "Total Overpayment" columns were estimated using the full sample of African-American, Hispanic, and Asian and/or Pacific Islander borrowers and not just those who paid more than the non-Hispanic white average markup.

– Estimated Disparities and Direct Consumer Damages for Subvented and Non-subvented Loans

Period of Review: January 1, 2011 to December 31, 2013

	Prohibited Basis Group	Number of Affected Prohibited Basis Borrowers	Markup Disparity	Total Overpayment	Number of Harmed Prohibited Basis Borrowers[31]	Overpayment per Harmed Prohibited Basis Borrower
Non-subvented	African Americans	116,586	27 basis points	$25.7 million	66,016	$390
Non-subvented	Asian and/or Pacific Islanders	109,544	18 basis points	$14.1 million	58,601	$240
Subvented	African Americans	7559	25 basis points	$1.5 million	2668	$562
			TOTAL:	**$41.3 million**	**Average:**	**$325**

[31] This column shows the estimated numbers of African-American and Asian and/or Pacific Islander borrowers who paid more than the non-Hispanic white average markup, consistent with the approach in *Ally*. Note that, consistent with the approach in *Ally*, the "Markup Disparity" and "Total Overpayment" columns were estimated using the full sample of African-American and Asian and/or Pacific Islander borrowers and not just those who paid more than the non-Hispanic white average markup.

[redacted] – Estimated Disparities and Direct Consumer Damages for Non-subvented Loans

Period of Review: January 1, 2011 to December 31, 2013

Prohibited Basis Group	Number of Affected Prohibited Basis Borrowers	Markup Disparity	Total Overpayment	Number of Harmed Prohibited Basis Borrowers[32]	Overpayment per Harmed Prohibited Basis Borrower
African Americans	91,705	23 basis points	$18.0 million	52,877	$340
Asian and/or Pacific Islanders	39,900	14 basis points	$3.8 million	21,528	$177
		TOTAL:	**$21.8 million**	**Average:**	**$293**

These disparities are statistically significant at the 5 percent level or better, well within what the courts generally require.[33] Such significant statistical evidence is of a kind and

[32] This column shows the estimated numbers of African-American and Asian and/or Pacific Islander borrowers who paid more than the non-Hispanic white average markup, consistent with the approach in *Ally*. Note that, consistent with the approach in *Ally*, the "Markup Disparity" and "Total Overpayment" columns were estimated using the full sample of African-American and Asian and/or Pacific Islander borrowers and not just those who paid more than the non-Hispanic white average markup.

[33] *Castaneda v. Partida*, 430 U.S. 482, 496 n.17 (1977) (noting that, for large samples, a difference greater than two or three standard deviations is, as a general rule, significant); *Ford v. Seabold*, 841 F.2d 677, 689 n.12 (6th Cir. 1988) (noting that the two or three standard deviation benchmark applied by the Supreme Court in *Castaneda* is essentially equivalent to a probability value of 0.05 and 0.01, respectively); *see also Albemarle Paper*, 422 U.S. at 437 (finding that a coefficient of correlation is statistically significant at 95%); *Hazelwood School Dist. v. United States*, 433 U.S. 299, 318 n.5 (1977) (Stevens, J., dissenting) (indicating that an approximation of two standard deviations at 5% is acceptable). *But see Watson v. Fort Worth Bank & Trust*, 487 U.S. 977, 995 n.3 (1988) ("We have emphasized the useful role that statistical methods can have in Title VII cases, but we have not suggested that any particular number of 'standard deviations' can determine whether a plaintiff has made out a prima facie case in the complex area of employment discrimination"). For further discussion of this topic, see David H. Kaye & David A. Freedman, *Reference Guide on Statistics*, in

degree sufficient to show that the Honda, , and dealer markup and compensation policies caused disparities based upon race and national origin.

In order to evaluate the robustness of the results, BLDS re-estimated markup disparities using models that controlled for a variety of factors, including credit tier, new/used status, term, markup cap, and dealer. We included these controls to account for variations in markup based upon these factors. Dealer and dealer compensation system controls were tested because different dealers could have different tendencies to mark up interest rates and their incentives to mark up rates could differ under different dealer compensation systems. When controlling for credit tier, new/used status and loan term, the disparities fell by approximately half for American-American and Hispanic borrowers and rose or remained the same for Asian/Pacific Islanders.[34] When controlling for the lenders' different markup caps, the disparities actually rose or were only reduced by 5 bps.[35] When controlling for dealer, the disparities fell 1-8 bps, and did not fall below 10 bps.[36]

Annotated Reference Manual on Scientific Evidence, 83, IV.B.2 (Fed. Judicial Ctr. Ed., 2d ed. 2000).

[34] Honda's fell to 18 basis points for African-Americans, to 12 basis points for Hispanics, and rose to 27 basis points for Asians. fell to 13 basis points for African Americans, rose to 20 basis points for Asian/Pacific Islanders, and fell to 15 basis points for African-Americans purchasing subvented vehicles. fell to 9 basis points for African-Americans and remained the same for Asian/Pacific Islanders. Although, as noted, disparities fell below 10 bps to 9 bps for African Americans when all of these controls were included in the model, we would likely not accept all of these controls as appropriate in negotiations regarding the analysis. In addition, in the unlikely event that we did consider including such controls as potentially appropriate, we would conduct additional analyses to refine our understanding of the impact of credit tier on markup given the changes in credit tier system over the relevant time period.

[35] Honda's rose to 38 basis points for African-Americans, to 29 basis points for Hispanics, and fell to 20 basis points for Asian/Pacific Islanders. rose to 31 basis points for African Americans, fell to 13 basis points for Asian/Pacific Islanders, and remained the same for African-Americans purchasing subvented vehicles. rose to 26 basis points for African-Americans and to 15 basis points for Asian/Pacific Islanders.

[36] Honda's fell to 33 basis points for African-Americans, to 25 basis points for Hispanics, and fell to 18 basis points for Asian/Pacific Islanders. fell to 23 basis points for African Americans, fell to 14 basis points for Asian/Pacific Islanders, and fell to 17 basis points for African-Americans purchasing subvented vehicles. fell very slightly to 22 basis points for African-Americans and to 13 basis points for Asian/Pacific Islanders.

In addition, BLDS generated disparity estimates using alternative methods of estimating the disparities based on the assigned proxies. Specifically, BLDS estimated the disparities using the weighted regression methodology which, while likely underestimating the disparities, accounts for the possibility that the disparities could be caused by non-racial/ethnic reasons.[37] Using this estimation method, the disparities fell by 4-14 bps, but did not fall below 10 bps.[38]

2. Inadequate Fair Lending Monitoring and Remedial Action

None of the three lenders had adequate fair lending compliance programs in place during the period under review. Honda's compliance department performed general monitoring for compliance and conducted targeted monthly reviews of random samples of approved and declined contracts to determine if they complied with federal and state fair lending requirements. During the five-year period prior to receiving the Bureau/DOJ Request for Information, Honda did not perform any analyses to confirm compliance with federal fair lending laws in the area of pricing.

Prior to the joint Bureau/DOJ investigation, [redacted] maintained no automated system to perform fair lending testing of consumer auto loan pricing data. Sometime prior to the issuance of CFPB Bulletin 2013-02, Indirect Auto Lending and Compliance with the Equal Credit Opportunity Act, on March 21, 2013, [redacted] engaged outside counsel to commence a qualitative and quantitative fair lending risk assessment of its indirect auto lending practices. [redacted] has begun to develop and implement a fair lending compliance program for its indirect automobile lending business. The program includes dealer-level statistical analysis with escalating dealer corrective action. Notably, it also includes portfolio-wide statistical analysis to identify disparities above 10 bps,[39] and consumer remuneration of identified disparities. [redacted] has conducted portfolio-wide analysis looking back as far as 2011 and has begun consumer remuneration. However, the program was not in place during the review period and remains in its infancy. Thus, it is difficult to determine whether it will adequately address the fair lending risk of [redacted] dealer markup policy.

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[37] The weighted regression methodology does not use probabilities directly in the regression; instead, each observation is turned into multiple observations, one for each race/ethnicity, and each of these observations is weighted by the corresponding race / ethnicity probabilities in the regression analysis.

[38] Honda's fell to 20 basis points for African Americans, 22 basis points for Hispanics, and 19 basis points for Asian and/or Pacific Islanders. [redacted] fell to 14 basis points for African Americans, to 14 basis points for Asian and/or Pacific Islanders, and to 11 basis points for African-American purchasing a subvented [redacted] vehicle; and [redacted] fell to 12 basis points for African Americans and 10 basis points for Asian and/or Pacific Islanders.

[39] [redacted] threshold varies slightly from the threshold applied in *Ally* and other supervisory resolutions in that the Bureau would want disparities of exactly 10 bps to be remediated.

[redacted] had what it terms as "active monitoring" by assigned personnel, including the Legal Department Compliance Team, Credit Department, and Internal Audit Department. [redacted] monitored state maximum contract rate compliance, compliance with dealer rate participation caps, compliance with applicable federal and state laws, and compliance with its dealer plans. However, [redacted] had not conducted any statistical analysis of its loans for compliance with fair lending laws as part of its compliance with the ECOA within the five years prior to our investigation. On [redacted] but they did not share the results of such analysis with the Bureau, claiming privilege over the material.

B. The Legitimate Business Need Defense

Once the Bureau has identified a specific facially neutral practice or policy used by the defendant, and demonstrated through statistical evidence that the practice or policy has caused an adverse effect on the protected group, as outlined above, the burden then shifts to the defendant to prove a legitimate business need for the practice or policy.

Honda, [redacted], and [redacted] have not yet asserted that their dealer markup and compensation policies are justified by a legitimate business need. However, several other automobile lenders have, and we anticipate that Honda, [redacted], and [redacted] will ultimately make the argument that they cannot unilaterally reduce or eliminate dealer reserve without substantial risk to their business. In this regard, other lenders have noted that attempts to eliminate dealer reserve will result in dealers simply offering their contracts to competing lenders. Indeed, anecdotally, [redacted] previously attempted to unilaterally move to flat fee compensation, and lost significant market share as a result; it returned to dealer markup shortly thereafter.

While discretionary pricing may be a legitimate industry practice standing alone, when it results in higher markups for members of a protected group, such disparities cannot be justified solely by pointing to other lenders engaged in a similar potentially discriminatory policy. Moreover, this argument was explicitly rejected in *Smith v. Chrysler Financial Co.*, 2003 WL 328719, at *7 (D.N.J. Jan. 15, 2003); there, the court rejected the defendants' argument "that their actions are not improper because they are simply following a recognized business practice within the financial industry," noting that "[t]hese arguments are not compelling because the law does not allow subjective mark-up policies that result in discrimination against a protected class absent a valid business justification."

Nonetheless, we anticipate that Honda, [redacted], and [redacted] will contend that they had a competitive need to have dealer markups. Thus, Honda, [redacted], and [redacted] may be able to convince a court that they had a legitimate business need for their policies.

C. Less Discriminatory Alternative: Alternative Dealer Compensation Structure or Effective Monitoring, Controls, and Training

In the event that a defendant is able to prove a legitimate business need for the practice or policy, the plaintiff can still prevail if there is a less discriminatory alternative that meets the business need.[40] In this matter, even if Honda, [redacted], and [redacted] could identify a legitimate business need for the discretionary dealer markup and compensation policy, less discriminatory alternatives are available. For example, if their argument is simply that they need to compensate dealers, adopting a non-discretionary dealer compensation program or lowering their current caps on dealer markups are less discriminatory alternatives. As noted above, there exists anecdotal evidence to support the argument that being the only lender to shift to nondiscretionary dealer compensation would significantly undermine competitiveness. On the other hand, if being a first-mover to non-discretionary compensation or lower caps risks losing significant market share, a less discriminatory alternative would be a discretionary markup and compensation policy with appropriate monitoring, controls, training, and borrower remuneration. Nothing precluded Honda, [redacted], or [redacted] from employing adequate monitoring and controls during the review period.

D. ANTICIPATED ARGUMENTS[41]

1. Liability of Indirect Auto Lenders

The captive lenders are likely to argue that they are not liable under the ECOA because they are not "creditors" as defined by the statute and Regulation B but merely potential assignees that play no role in deciding the amount of the dealer markup. However, while the captives may attempt to distinguish themselves from the definition of "creditor" set forth in the ECOA and Regulation B, their practice of evaluating an applicant's information, establishing a buy rate specific to that applicant, communicating that buy rate to the dealer, and indicating that they will purchase the obligation at the designated buy rate plus an articulated range of dealer markup if the transaction is consummated, very likely make them creditors under the ECOA.

The ECOA defines a "creditor" to include not only "any person who regularly extends, renews or continues credit," but also "any *assignee* of an original creditor who

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[40] *See Albemarle,* 422 U.S. at 425.

[41] Although the Bureau notified the entities of our preliminary findings, the Bureau did not send PARR letters to the captives under consideration in order to expedite the matters. Therefore, we do not have specific insight into arguments they may raise in response to any action we take. These arguments are based on our experience with other lenders, some of which have been represented by attorneys who are representing these captives under consideration, and arguments they have raised.

participates in the decision to extend, renew, or continue credit."[42] Regulation B further provides that "creditor" means "a person, who, in the ordinary course of business, regularly participates in a credit decision, including setting the terms of credit" and expressly includes an "assignee, transferee, or subrogee who so participates."[43] The Commentary to Regulation B makes clear that an assignee is considered a "creditor" when the assignee participates in the credit decision. The Commentary provides that a "creditor" "includes all persons participating in the credit decision" and that "[t]his may include an assignee or a potential purchaser of the obligation who influences the credit decision by indicating whether or not it will purchase the obligation if the transaction is consummated."[44]

The captives may argue that the loan contract is between the dealer and the borrower and the Bank is only later "assigned" the loan. But this ignores their actual practice of communicating to the dealers for each application a buy rate plus the articulated range of dealer markup at which they will purchase a particular loan. In doing so, they influence the credit decision. Regulation B and its Commentary explicitly bring such conduct under the definition of "creditor."[45]

As an extension of this argument, the captives may also contend that Regulation B exempts them from liability because Regulation B provides that "[a] person is not a creditor regarding any violation of the Act or this regulation committed by another creditor unless the person *knew or had reasonable notice of the act, policy, or practice* that constituted the violation before becoming involved in the credit transaction."[46] They may argue that they lacked any such knowledge or reasonable notice. This argument is based on an improper interpretation of this provision of Regulation B. The reasonable notice provision of Regulation B limits a creditor's liability for *another* creditor's ECOA violations under certain circumstances. It does not limit the captives' liability for their *own* violations stemming from the disparate impact of their *own* dealer markup and compensation policy. Nor does the provision absolve them of their duty under the ECOA to adequately monitor the loans they have purchased for any potential

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[42] 15 U.S.C. § 1691a(e) (emphasis added).

[43] 12 C.F.R. § 1002.2(*l*).

[44] 12 C.F.R. pt. 1002, Supp. I, § 1002.2, ¶ 2(*l*)-1.

[45] Furthermore, the Bureau recently affirmed its position in the Auto Bulletin that indirect auto lenders are likely creditors under the ECOA and Regulation B given the lender's typical participation in the transaction. *See* CFPB Auto Bulletin 2013-02, *Indirect Auto Lending and Compliance with the Equal Credit Opportunity Act* (March 21, 2013), available at http://files.consumerfinance.gov/f/201303_cfpb_march-Auto-Finance-Bulletin.pdf ("Auto Bulletin").

[46] 12 C.F.R. § 1002.2(1))(emphasis added).

illegal disparate impact caused by their *own* policies and practices and to remedy harmed consumers accordingly.[47]

2. *Wal-Mart Stores, Inc. v. Dukes*[48]

The captives may also cite to the Supreme Court's decision in *Wal-Mart Stores, Inc. v. Dukes,* to refute the Bureau's position that their dealer markup and compensation policies, and not the dealer's exercise of discretion under those policies, could constitute the "act, policy, or practice" that could have an illegal disparate impact under the ECOA.

In *Dukes,* the plaintiffs, female employees of Wal-Mart, alleged in part that their local managers' discretion over pay and promotions violated Title VII because it was exercised disproportionally in favor of men and therefore had an unlawful disparate impact on women.[49] The plaintiffs sought certification of a Rule 23(b)(2) nationwide class of all of Wal-Mart's current and former female employees, about 1.5 million class members.[50] The Supreme Court held in relevant part that class certification was inappropriate because the plaintiffs did not satisfy Rule 23(a)'s commonality requirement because they failed to provide proof of a "companywide discriminatory pay and promotion policy."[51]

In *Dukes,* the relevant policy being challenged as having a disparate impact was "Wal-Mart's 'policy' of *allowing discretion* by local supervisors over employment matters."[52] The Court acknowledged that it had previously held that "'in appropriate cases,' giving discretion to lower-level supervisors can be the basis of Title VII liability under a disparate-impact theory—since 'an employer's un-disciplined system of subjective decision-making [can have] precisely the same effects as a system pervaded by impermissible intentional discrimination.'"[53] Nonetheless, the Court concluded that the plaintiffs had "not identified a common mode of exercising discretion that pervades the entire company."[54] Wal-Mart's policy of discretion was therefore not a

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[47] The Bureau considered and generally rejected this interpretation of Regulation B in the Auto Bulletin. *See* Auto Bulletin at 3.

[48] 131 S. Ct. 2541 (2011).

[49] *Id.* at 2548.

[50] *Id.* at 2546.

[51] *Id.* at 2556.

[52] *Id.* at 2554 (emphasis in original).

[53] *Id.* (quoting *Watson v. Fort Worth Bank & Trust,* 487 U.S. 977, 990-91 (1988)).

[54] *Id.* at 2554-55.

"companywide discriminatory pay and promotion policy" that could demonstrate commonality.[55]

In reaching this conclusion, the Court rejected the plaintiffs' statistical evidence that the policy resulted in an overall sex-based disparity, stating that "[i]nformation about disparities at the regional and national level does not establish the existence of disparities at individual stores, let alone raise the inference that a company-wide policy of discrimination is implemented by discretionary decisions at the store and district level."[56] The Court went on to state that the discretionary policy at issue was not a "specific employment practice" that could be challenged under a disparate impact theory: "Other than the bare existence of delegated discretion, respondents have identified no 'specific employment practice'—much less one that ties all their 1.5 million claims together. Merely showing that Wal-Mart's policy of discretion has produced an overall sex-based disparity does not suffice."[57]

In particular, the captives may contend that *Dukes* stands for the proposition that allowing discretion by local supervisors over employment matters does not raise an inference of discriminatory conduct and thus is not a specific act, policy, or practice that supports disparate impact liability under the ECOA, and instead the individual decisions of different dealers constitute the specific acts, policies, or practices. They may also argue that *Dukes* overrules or undermines previous federal district court decisions that concluded that an indirect auto lender's decision to permit discretionary markups can support a violation of ECOA under a disparate impact analysis.[58]

Prior to *Dukes*, a number of courts specifically held that dealer markup policies similar to these captives' constitute a "specific policy or practice" sufficient to establish a prima facie case under a disparate impact analysis. For example, in *Coleman v. General Motors Acceptance Corp.,* the district court, relying upon the Supreme Court's holding in *Watson v. Fort Worth Bank and Trust*,[59] denied the employer's motion for summary judgment and held that the use of disparate impact was appropriate when the lender's policy "is race neutral (or objective) by its terms," but "[w]hen exercised by those granted discretion under the neutral policy, its effect is to discriminate."[60]

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[55] *Id.* at 2556.

[56] *Id.* at 2555 (internal quotations and citations omitted).

[57] *Id.* at 2555-56.

[58] *See, e.g., Smith v. Chrysler Fin. Co. L.L.C.*, 2003 WL 328719 (D.N.J. 2003) (denying motion to dismiss by indirect auto lender); *Jones*, 2002 WL 88431; *Osborne*, 234 F. Supp. 2d 804; *Wise* ex rel. *Estate of Wilson*, 2002 WL 31730920.

[59] 487 U.S. 977, 994 (1988).

[60] *Coleman*, 196 F.R.D. 315, 327 (M.D. Tenn. 2000) (certifying the class and denying motion for summary judgment), *vacated and remanded on unrelated grounds,* 296 F.3d 443 (6th Cir. 2002). *See also Jones v. Ford Motor Credit Co.*, 2002 WL 88431 *4

The captives may argue that *Dukes* overruled or undermined these decisions, and that *Dukes* precludes disparate impact claims that rely on allowing discretion as the specific policy or practice that violates the ECOA. Nevertheless, there are some bases on which we can distinguish *Dukes*.

First, the holding of *Dukes* was limited to the class certification context.[61] The Bureau is not subject to the class certification limitations imposed by the decision. Furthermore, nowhere in the *Dukes* decision does the Supreme Court state that commonality applies to claims outside of the class action context. Nor did the Court conclude that discretion cannot be the basis for liability under a disparate impact theory.[62]

Limiting *Dukes* to the class certification context is supported by case law. Post-*Dukes*, both the Seventh and Tenth Circuit Courts of Appeals have upheld suits claiming that discretionary practices may form the basis for an individual disparate impact claim. In *Tabor v. Hilti*,[63] two individual plaintiffs alleged that their employer's discretionary performance management process was a specific policy that resulted in an illegal discriminatory impact.[64] The Tenth Circuit rejected the defendant's arguments that *Dukes* precluded relying on this discretionary policy as a "specific policy" that could form the basis of plaintiffs' disparate impact claim; the court noted that the holding of *Dukes* was limited to commonality, and that *Dukes* did not disturb pre-existing

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(S.D.N.Y. Jan. 22, 2002) (denying a motion to dismiss and holding that plaintiffs could bring a disparate impact claim under ECOA regarding defendant's role in authorizing subjective markups); *Osborne v. Bank of America Nat'l Ass'n.*, 234 F. Supp. 2d 804, 812 (M.D. Tenn. 2002) (denying motion to dismiss and holding that the bank's policy of authorizing subjective markups was sufficient to state a disparate impact claim under ECOA); *Wise* ex rel. *Estate of Wilson v. Union Acceptance Corp.*, 2002 WL 31730920 (S.D. Ind. Nov. 19, 2002) (denying motion to dismiss and holding that plaintiff can bring a disparate impact claim under ECOA where the discriminatory practice is subject finance charge markups). Although these decisions were decided at the motion to dismiss stage, they are nonetheless relevant because the courts agree that as a matter of law, a discretionary markup is sufficient to state a disparate impact claim under ECOA.

[61] *Dukes*, 131 S. Ct. at 2550-51.

[62] *Id.* at 2554 (*Dukes* reaffirmed that "we have recognized that 'in appropriate cases,' giving discretion to lower level supervisors can be the basis of Title VII liability under a disparate impact theory — since 'an employer's undisciplined system of subjective decision-making [can have] precisely the same effects as a system pervaded by impermissible intentional discrimination.'") (alteration in original) (quoting *Watson v. Fort Worth Bank & Trust*, 487 U.S. 977, 990–91 (1988)).

[63] 703 F.3d 1206 (10th Cir. 2013).

[64] *Id.* at 1221-22.

precedent approving the disparate impact analysis of discretionary practices.[65] Similarly, in *Gschwind v. Heiden,*[66] the Seventh Circuit Court of Appeals did not prohibit an individual from challenging a school district's policy of granting discretion to administrators, concluding that the holding in *Dukes* was limited to issues of commonality in the class certification context.[67]

In addition, specific to lending discrimination, at least one court has noted that *Dukes*'s holding is limited to class certification. In *Illinois v. Wells Fargo & Co.*,[68] the Illinois Attorney General sued Wells Fargo under various state laws including the Illinois Human Rights Act, alleging that Wells Fargo engaged in illegal discrimination through reverse redlining and by steering minorities into more expensive loans than similarly situated White borrowers.[69] In denying a motion to dismiss the disparate impact claims, the court found that *Dukes* did not apply, stating that "the pertinent issue [in *Dukes*] was whether the plaintiff demonstrated questions of law and fact common to the class, an issue not pending before this Court."[70]

Finally, since the *Dukes* decision, the DOJ and the Bureau have filed and settled a number of other complaints alleging unlawful pricing discretion via a disparate impact analysis that were approved by the courts.[71] Among these, *Consumer Financial*

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[65] *Id.*

[66] 692 F. 3d 844 (7th Cir. 2012).

[67] *Id.* at 848. In *Gschwind,* a school administrator, with the school district's approval, fired a teacher who had filed a criminal complaint against a student. The teacher sued the school district on the grounds that the criminal complaint was protected by the First Amendment. In finding for the plaintiff, the court noted that *Dukes* distinguished between the lack of commonality among class members when supervisors made the employment decisions of which the class is complaining and the possibility that discretion given to supervisors in an "undisciplined system of subjective decision-making" can have a discriminatory effect. *Id.* (quoting *Watson v. Fort Worth Bank & Trust*, 487 U.S. 977, 990–91).

[68] No. 09-26434 (Ill. Cir. Ct. Cook County Oct. 25, 2011).

[69] *Id.* at 1.

[70] *Id.* at 9 n.1 (citations omitted).

[71] *See, e.g.*, Consent Order, *United States v. SunTrust Mortgage, Inc.*, No. 3:12-cv-397 (E.D. Va. May, 31, 2012), *available at* http://www.justice.gov/iso/opa/resources/3132012531162538304 20.pdf; Consent Order, *United States v. Countrywide Fin. Corp.*, No. CV11-10540-PSG (AGW) (C.D. Cal. Dec. 28, 2011), available at http:// www.justice.gov/crt/about/hce/documents/countrywidesettle.pdf; Consent Order, *United States v. GFI Mortgage Bankers, Inc.*, No. 12-cv-2502-KBF (S.D.N.Y. Aug. 27, 2012), *available at* http://www.justice.gov/crt/about/hce/documents/gfisettle.pdf; Consent Order, *Consumer Financial Protection Bureau et al v. National City Bank*,

Protection Bureau v. National City Bank,[72] stands out. In *Rodriguez v. National City Bank*,[73] involving allegations that National City's discretionary pricing structure was discriminatory, the district court denied certifying a settlement class on the basis of *Dukes*.[74] This was affirmed by the Third Circuit Court of Appeals.[75] The Bureau and the DOJ later filed a proposed consent order settling nearly identical claims.[76] That consent order was entered by the court within seventeen days.[77]

Second, assuming we fail in limiting *Dukes's* holding to class certification, we could attempt to distinguish the dealer markup and compensation policy at issue here from the discretionary policy at issue in *Dukes*. The captives' potential arguments are, however, supported in part by several decisions that have, almost uniformly, held that wholesale lender liability under the disparate impact doctrine for allowing broker discretion does not meet the commonality requirement for class certification. While these decisions were made in the class certification context, they nonetheless mirror language in *Dukes* that a discretionary policy is not specific enough to support a disparate impact claim.

For example, in *Rodriguez*,[78] the Third Circuit Court of Appeals affirmed denial of class certification in a case regarding pricing discretion to brokers, noting that the case "bears a striking resemblance to *Dukes*."[79] In doing so, the court emphasized the dicta in *Dukes*, stating that for discretionary policies to be the basis for a successful disparate impact claim, the suit "must also identify 'the specific employment practice that is challenged'" in addition to the statistical evidence of a disparate discriminatory impact.[80] The court went on to add that "to bring a case as a class action, the named

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2:13-cv-01817 (W.D. Penn. Dec. 23, 2013), *available at* http://www.justice.gov/crt/about/hce/documents/nationalcitybanksettle.pdf; Consent Judgment, *United States v. Ally Financial Inc.*, 2:13-cv-15180 (Dec. 23, 2013), *available at* http://www.justice.gov/crt/about/hce/documents/allyco.pdf.

[72] *National City Bank*, 2:13-cv-01817.

[73] *Rodriguez v. National City Bank* , 277 F.R.D. 148 (3d Cir. 2013).

[74] *Id.* at 150, 154-55.

[75] *Id.* at 374-75, 385-86.

[76] *National City Bank*, 2:13-cv-01817.

[77] Consent Order (adopted), *Consumer Financial Protection Bureau v. National City Bank* 2:13-cv-01817 [Dkt. No. 3] (January 9, 2014).

[78] 726 F.3d 372, 383 (3d Cir. 2013).

[79] *Id.* at 384.

[80] *Id.* at 383.

plaintiffs must show that each class member was subjected to the specific challenged practice in roughly the same manner."[81]

Similarly, in *In re Countrywide Financial Corp. Mortgage Lending Practices Litigation*,[82] the Sixth Circuit Court of Appeals rejected class certification in part because the challenged policy of allowing broker discretion did not dictate "how local actors exercise their discretion, such that the corporate guidance caused or contributed to the alleged disparate impacts."[83] Like *Rodriguez*, *Countrywide* emphasized the dicta in *Dukes* regarding the need for a specific practice beyond delegated discretion.[84] Although these cases arose in the context of class certification, the captives, as other defendants have, may focus on the language in these decisions which states or implies that discretion alone may not be specific enough to constitute a "specific practice" that can serve as the basis of disparate impact liability under the ECOA.

Contrary to these cases, the facts here are arguably distinguishable from *Dukes* because of the specific nature of the captives' policies. In *Dukes*, the defendants, a nationwide chain of thousands of stores, gave managers broad discretion over pay and promotions. Here, the captives did more than simply provide dealers with discretion to mark up the buy rate. They further *incentivized* them to do so by compensating the dealers from the increased interest revenue from the markup. Several plaintiffs have successfully distinguished *Dukes* in this manner, in part by presenting evidence of additional policies beyond discretionary authority.

For example, in *McReynolds v. Merrill Lynch*,[85] the Seventh Circuit Court of Appeals agreed that certification of a class action brought by African-American employees who alleged discrimination under Title VII was not barred by *Dukes* because of two important aspects in Merrill Lynch's policies: the formation of broker teams and

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[81] *Id.*

[82] 708 F.3d 704 (6th Cir. 2013).

[83] *Id.* at 708.

[84] *Id.* ("On this point, *Dukes* is clear: class members must unite acts of discretion under a single policy or practice, or through a single mode of exercising discretion, and the mere presence of a range within which acts of discretion take place will not suffice to establish commonality."); *see also Barrett v. Option One Mortgage Corp.*, No. 08-10157-RWZ, 2012 WL 4076465, *3 (D. Mass. Sept. 18, 2012) (denying class certification because plaintiffs did not "point to any common mode of exercising discretion that was shared by all... brokers"); *In re Wells Fargo Residential Mortgage Lending Discrimination Litigation*, 2011 WL 3903117, No. 08-01930, at 7 (N.D. Cal. Sept. 6, 2011) (rejecting class certification because "as the Supreme Court recognized in *Dukes*, where persons who are afforded discretion exercise that discretion differently, commonality is not established").

[85] 672 F.3d 482 (7th Cir. 2012).

the distribution of broker accounts.[86] In *McReynolds* the company had a specific policy that allowed brokers to form their own teams,[87] which, according to the plaintiffs, acted as "little fraternities" that chose members like themselves.[88] In addition, Merrill Lynch had a policy of letting brokers compete for accounts based on the amount of revenue they generated and clients they retained. The brokers on the best teams often received the best accounts, and plaintiffs alleged that this had a discriminatory impact.[89] The court found that these practices of Merrill Lynch were specific policies beyond merely the discretion of local managers, and as such differentiated the case from the general discretion provided by the employer in *Dukes*.[90]

Similarly, in *Scott v. Family Dollar Stores*,[91] the Fourth Circuit differentiated a class action suit alleging employment gender discrimination from *Dukes* pointing to specific policies such as a salary range, pay raise percentage policy, a method for evaluating pay based on prior experience, and a dual pay system for hires and promotes, which were exercised in a common way under common direction from corporate headquarters.[92] For example, the salary range policy set the mandatory maximum and minimum pay for store managers and resulted in disparities in the number of women at the upper pay levels and a higher rate of exceptions affording greater pay to male employees.[93] Similarly, the pay raise percentage policy based compensation on prior performance. Exceptions above that pay raise percentage were granted in significantly greater amounts for men. The court found that in part these "uniform corporate polices" distinguished the case from *Dukes* because they were exercised in a common way, under common direction.[94]

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[86] *Id.* at 488.

[87] *Id.*

[88] *Id.* at 489.

[89] *Id.*

[90] *Id.* at 490.

[91] 733 F.3d 105 (4th Cir. 2013).

[92] *Id.* at 116-17.

[93] *Id.* at 116.

[94] The *Scott* court gave significant weight to the involvement of "high level" manager decision-making, which is less relevant here. *Id.* at 117 (noting that the discretionary decisions are made by high level corporate decision makers with authority over a broad segment of the employees, not on an individual store level, as in *Dukes*); *see also Ellis v. Costco Wholesale Corp.*, 285 F.R.D. 492, 518 (N.D. Cal. 2012) (district court rejecting in a class action matter defendant's arguments that because of manager discretion the case was governed by *Dukes* because of a common mode of exercising discretion, specific practices that affected outcomes, and the involvement of senior management in the disputed processes); *Stinson v. New York*, 282 F.R.D. 360 (S.D.N.Y. 2012) (distinguishing *Dukes* because defendants established a specific policy of issuing

Like the defendants in *McReynolds* and *Scott*, the captives employed additional policies beyond merely permitting discretion. The captives, unlike Wal-Mart, had policies of incentivizing dealers to mark up loans and policies that specifically set aside a portion of that markup to be paid to the dealer. As practiced, these policies functioned as a corporate policy that influenced dealers to exercise discretion in a common way. It is this specific policy, not discretion alone, that has led to racial discrimination, and as such is arguably sufficient grounds to distinguish the instant case from the broad discretion discussed in *Dukes*. As noted, this argument has not been successful in distinguishing *Dukes* in the private class action context,[95] but we may succeed in making it given the different procedural context.

3. Disparate Impact Claims Are Appropriate Under the ECOA

The captives may challenge the Bureau's ability to bring disparate impact claims under the ECOA. We anticipate they will make such a challenge in negotiations and in any litigation, consistent with defendants in other matters, particularly in light of the Supreme Court's recent grant of certiorari in *Texas Dep't of Housing and Community Affairs v. The Inclusive Communities Project, Inc.*, No. 13-1371, -- S. Ct. ---, 2014 WL 4916193 (Oct. 2, 2014) and the November 7, 2014, District of Columbia District Court amended memorandum opinion (Judge Leon presiding) vacating HUD's disparate impact rule on the ground that the plain language of the Fair Housing Act does not recognize disparate impact claims. *American Insurance Assoc. v. HUD*, No. 13-00966 RJL (Nov. 7, 2014).

These arguments generally rely on the Supreme Court's decision in *Smith v. City of Jackson*,[96] which held that the Age Discrimination in Employment Act ("ADEA")[97] permitted disparate impact claims by comparing language in the ADEA to analogous

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summonses without probable cause to meet a quota, rather than a broad policy of corporate discretion). *But see Bolden v. Walsh Construction Co.*, 688 F.3d 893, 898 (7th Cir. 2012) (distinguishing *McReynolds* because of a lack of any relevant company-wide policy beyond discretion to managers).

[95] *Barrett v. Option One Mortgage Corp.*, No. 08-10157-RWZ, 2012 WL 4076465, *4 (D. Mass. Sept. 18, 2012) (rejecting argument that broker's discretion to set rates above the par rate distinguished the case from *Dukes*, because plaintiffs did not allege any common practice that the brokers used in exercising that discretion); *In re Wells Fargo Residential Mortgage Lending Discrimination Litigation*, 2011 WL 3903117, No. 08-01930, at 4 (N.D. Cal. Sept. 6, 2011) (rejecting plaintiff's argument that the bank's discretionary pricing policy which included markups and pricing exceptions, distinguished the matter from *Dukes* because there was no common mode of exercising discretion).

[96] 544 U.S. 228 (2005).

[97] 29 U.S.C. §§ 621 *et seq.*

language in Title VII. Specifically, in finding disparate impact liability under the ADEA, the plurality in *Smith* held that both Title VII and the ADEA contain language prohibiting actions that "deprive any individual of employment opportunities or *otherwise adversely affect* his status as an employee."[98] Although *Smith* is not an ECOA case, the captives' counsel, as well as other defendants, may argue that the ECOA does not have the statutory language cited in *Smith* and therefore disparate impact claims are not available under the ECOA.

The Bureau's position that disparate impact liability is available under the ECOA is consistent with the ECOA's governing regulation, legislative history, case law, and all other federal regulatory and enforcement agencies with ECOA jurisdiction. *First*, Regulation B specifically provides that disparate impact claims are available under the ECOA.[99] *Second*, the ECOA's legislative history explicitly states that the ECOA was intended to include disparate impact liability.[100] *Third*, *Smith* did not require the exact "effect" language in Title VII or the ADEA to be present in order for a disparate impact claim to be cognizable under other statutes. Instead, the court in *Smith* considered not only the statute's overall text, but also the governing regulations, the purposes of the act, and the uniform interpretation of the appellate courts in concluding that disparate impact claims were permitted.[101] Courts have consistently rejected the argument that, in view of *Smith*, disparate impact claims are not cognizable under the ECOA.[102] *Fourth*, as

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[98] *Smith*, 544 U.S. at 235 (emphasis in original).

[99] *See* 12 C.F.R. § 1002.6(a).

[100] Regulation B, ECOA's implementing regulation, specifically provides that Congress intended the ECOA to include disparate impact liability:

> The effects test is a judicial doctrine that was developed in a series of employment cases decided by the U.S. Supreme Court under Title VII of the Civil Rights Act of 1964 (42 U.S.C. 2000e et seq.), and the burdens of proof for such employment cases were codified by Congress in the Civil Rights Act of 1991 (42 U.S.C. 2000e–2). Congressional intent that this doctrine apply to the credit area is documented in the Senate Report that accompanied H.R. 6516, No. 94–589, pp. 4–5; and in the House Report that accompanied H.R. 6516, No. 94–210, p.5. The Act and regulation may prohibit a creditor practice that is discriminatory in effect because it has a disproportionately negative impact on a prohibited basis, even though the creditor has no intent to discriminate and the practice appears neutral on its face, unless the creditor practice meets a legitimate business need that cannot reasonably be achieved as well by means that are less disparate in their impact.

12 C.F.R. pt. 1002 Supp. I, para. 6(a)–2.

[101] *Smith*, 544 U.S. at 233-40 (plurality). In the court's textual analysis, it noted that where a statute permits disparate impact claims, the text focuses on the effects of the action rather than the motivation for the action. *Id.* at 236.

[102] See *Taylor v. Accredited Home Lenders, Inc.*, 580 F. Supp. 2d 1062, 1067 (S.D. Cal. 2008) ("There are no court decisions finding the ECOA and the FHA do not permit

set forth in the Interagency Policy Statement on Discrimination in Lending,[103] federal regulators have consistently recognized disparate impact liability under the ECOA for decades.

Although the Bureau has sound arguments on which to support disparate impact liability under the ECOA, the Supreme Court has granted certiorari three times in recent years to address the question of whether disparate impact liability exists under the Fair Housing Act (FHA).[104] The Court has done so even though the circuit courts have consistently held that disparate impact liability is available under the FHA. In addition, a D.C. District Court has just vacated HUD's disparate impact rule. Although this will likely embolden the captives to challenge disparate impact liability, we recommend continuing to press forward with such claims, consistent with the Bureau's Lending Discrimination Bulletin.[105]

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disparate impact actions in light of *Smith*. In fact, there are numerous decisions recognizing disparate impact claims under the statutes following the decision issued in *Smith*"); *Budnick v. Town of Carefree*, 518 F.3d 1109 (9th Cir. 2008) (providing elements necessary to establish a prima facie case of disparate impact under the FHA); *National Community Reinvestment Coalition v. Accredited Home Lenders Holding Co.*, 573 F.Supp.2d 70 (D.D.C. 2008) (finding *Smith* does not preclude disparate impact claims under the FHA); *Ramirez v. GreenPoint Mortgage Funding, Inc.*, 2008 WL 2051018 (N.D. Cal. 2008) (finding disparate impact claims cognizable under both the FHA and the ECOA); *Masudi v. Ford Motor Credit Co.*, 2008 WL 2944643 (E.D.N.Y. 2008) (recognizing the ECOA allows disparate impact actions); *Zamudio v. HSBC North America Holdings, Inc.*, 2008 WL 517138 (N.D .Ill. 2008) (finding disparate impact claims are available under both the ECOA and the FHA); *Graoch Associates # 33. L.P. v. Louisville/Jefferson County Metro Human Relations Comm'n*, 508 F.3d 366 (6th Cir. 2007) (discussing burden-shifting in disparate impact claims brought under the FHA); *Beaulialice v. Federal Home Loan Mortgage Corp.*, 2007 WL 744646 (M.D. Fla. 2007) (finding the plaintiff may bring a disparate impact claim under the FHA); *Affordable Housing Development Corp. v. City of Fresno*, 433 F.3d 1182, 1195 (9th Cir. 2006) (recognizing disparate impact claims under the FHA).

[103] *See* 59 Fed. Reg. 18,266, 18,271 (1994). The statement was adopted by HUD, OFHEO, DOJ, OCC, OTS, FRB, FDIC, FHFB, FTC, and NCUA, members of the Interagency Task Force on Fair Lending.

[104] *Gallagher v. Magner*, 619 F.3d 823 (8th Cir. 2010), *cert. granted*, 132 S. Ct. 548 (Nov. 7, 2011); *Township of Mount Holly v. Mount Holly Gardens Citizens in Action, Inc.*, 658 F.3d 375 (3d Cir. 2012), *cert. granted*, 133 S. Ct. 2824 (June 17, 2013); *Texas Dep't of Housing and Community Affairs v. The Inclusive Communities Project, Inc.*, No. 13-1371, -- S. Ct. ---, 2014 WL 4916193 (Oct. 2, 2014).

[105] *See* Lending Discrimination, *supra* note 14.

4. Bureau's Proxy Methodology

The captives may also assert that the geographic- and surname-based race and ethnicity proxies that the Bureau employed are too unreliable to support a disparate impact claim. Like other indirect auto lenders, the captives may conduct their own independent analysis of the Bureau's proxy methodology and contend that the Bureau's proxy method is inadequate to support a disparate impact claim because it is unable to accurately identify target and control group borrowers. [redacted] purportedly replicated the Bureau's proxy methodology based upon their own HMDA data and compared the proxied race and ethnicity to the race and ethnicity reported in the HMDA data. Counsel reported that the proxy methodology very poorly identified Hispanics and African Americans in the HMDA data.[106]

However, the Bureau's Office of Research published a White Paper, Using Publicly Available Information To Proxy For Unidentified Race and Ethnicity (Summer 2014), which supports the reliability of the Bureau's proxy methodology. The paper concluded that the BISG proxy probability is more accurate than a geography-only or surname-only proxy in its ability to predict individual applicants' reported race and ethnicity and is generally more accurate than a geography-only or surname-only proxy at approximating the overall reported distribution of race and ethnicity. Additionally, in general, while some courts have recognized that proxies are merely estimations of protected characteristics and their predictive power may be limited in some circumstances,[107] many others have accepted the use of reliable proxy methods in a

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[106] For example, one lender reported based on its analysis of its own HMDA data that the proxy methodology was only able to identify 56.9% of the Hispanic and 18.9% of the African-American applications in the HMDA data (*i.e.*, false negative); in other words, for every 100 African-American applicants in the HMDA data, the proxy methodology could only identify roughly 19 of them as African Americans. Moreover, only 54% of the applicants identified by the proxy methodology as African-American were actually African-American and 66.5% of the applications identified by the proxy methodology as Hispanic were actually Hispanic (*i.e.*, false positive); in other words, out of 100 applicants that are identified by the proxy methodology as African Americans, only 54 of them are actually African Americans according to the HMDA data.

[107] Some courts have expressed skepticism of surname analysis when its accuracy was called into question in that particular instance. *See, e.g., I.M.A.G.E. v. Bailar*, 518 F. Supp. 800, 806-07 (N.D. Cal. 1981)(questioning the probative value of defendant's surname analysis because of, among other reasons, a large population of Portuguese and Filipinos residents in the area with names on the Spanish surname list). Even where courts are skeptical of surname analysis, they may consider it as evidence if its usefulness can be shown. *See, e.g., Rodriguez v. Bexar County*, 385 F.3d 853, 866, n.18 (5th Cir. 2004) (expressing its opinion that Spanish surname analysis is "novel and highly problematic," but upholding the district court's consideration of it and allowing it in future cases upon a "strict showing of its probativeness").

variety of discrimination suits, including ECOA actions,[108] Voting Rights Act suits,[109] employment discrimination actions,[110] and constitutional challenges to jury pool selections.

V. RECOMMENDATION TO SETTLE OR SUE

A. Summary

We seek authority to negotiate a settlement containing the following elements:

(1) An injunction, with various affirmative requirements, prohibiting Honda, [redacted], and [redacted] from violating the ECOA and ordering either significant enhancements to their auto lending compliance monitoring programs including paying remediation for any markup disparities identified by the program for loans originated on or after January 1, 2015, or the adoption of an alternative dealer compensation structure that either eliminates or substantially limits dealer discretion;

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[108] *See, e.g., United States v. Union Auto Sales, Inc.*, 490 F. App'x 847, 849 (9th Cir. 2012) ("classification of 'Asians' and 'non-Asians' did not render the ECOA claim any less plausible" because "[t]he link between names and racial categorization for the purposes of both antidiscrimination law and discriminatory conduct is well-established").

[109] *See, e.g., Benavidez v. City of Irving*, 638 F. Supp. 2d 709, 717 (N.D. Tex. 2009) ("The Spanish surname may be used as a proxy for Hispanic ethnicity when self-identification is not practical."); *United States v. Village of Port Chester*, No. 06 Civ. 15173(SCR), 2008 WL 190502, at *9 n.13 (S.D.N.Y. Jan. 17, 2008) ("Experts for both parties used the Census Bureau List of Spanish Surnames to calculate the number of Hispanic voters in a particular area . . . . Neither party disputes that Spanish Surname Analysis is an accepted methodology.").

[110] *See, e.g., E.E.O.C. v. Autozone, Inc.*, No. 00-2923 Ma/A, 2006 WL 2524093, at *5 (W.D. Tenn. Aug. 29, 2006) (finding that "it was reasonable for [the government's expert] to use census proxy data rather than the actual applicant data"); *I.M.A.G.E.*, 518 F. Supp. 807 ("[M]any Title VII discrimination suits have relied on Spanish surnames as an identifier for evaluating adverse impact and for affecting relief."); *Guardians Ass'n of New York City Police Dep't, Inc. v. Civil Serv. Comm'n of City of New York*, 431 F. Supp. 526, 530 (S.D.N.Y. 1977), *vacated and remanded on other grounds*, 562 F.2d 38 (2d Cir. 1977) (holding that the use of three statistical methods to estimate race and national origin, including the proxy methods of surname analysis and geocoding, was "clearly trustworthy"); *Com. of Pa. v. O'Neill*, 348 F. Supp. 1084, 1086 (E.D. Pa. 1972), *aff'd in relevant part, vacated in part on other grounds*, 473 F.2d 1029 (3d Cir. 1973) (finding expert's race estimations from geocoding "reasonable").

(2) Remediation to African-American, Hispanic, and Asian and/or Pacific Islander borrowers who were injured by Honda, [redacted], and [redacted] discriminatory practices in the below-stated ranges, reflecting direct and indirect damages to those borrowers from January 1, 2011 to December 31, 2014;

(3) Proportional civil money penalties as described below; and

(4) Additional provisions generally consistent with efforts to remediate the conduct described in this memo.

B. Discussion

1. Injunctive Relief

We seek authority to negotiate settlements with Honda, [redacted], and [redacted] that would include injunctive provisions to correct the identified ECOA violations and prevent future ECOA violations. We seek authority to negotiate prospective compliance measures, which will likely require them to adopt one of the following models of dealer compensation:

1. Nondiscretionary dealer compensation and pricing policy.
   a) Lender will maintain policies that do not allow dealers any discretion to set the contract rate.
   b) Lender will maintain general compliance management systems to monitor for compliance with all federal consumer financial laws, including ECOA.
      - This will include Lender sending regular notices to all dealers explaining the ECOA, stating Lender's expectation with respect to ECOA compliance, and articulating the dealer's obligation to price retail installment contracts in a non-discriminatory manner.
   c) Lender will **not** be required to implement enhanced compliance management systems set forth in paragraphs 2(c) and 3(c) below.
   d) Lender will **not** have to review or remunerate for prohibited basis disparities resulting from dealer discretion in setting the contract rate, because there is no such discretion.
2. Dealer compensation and pricing policy with more limited dealer discretion.
   a) For retail installment contracts with a term of sixty (60) months or less, Lender will maintain policies limiting dealer discretion in setting the contract rate to 100 bps, and for retail installment contracts with a term greater than sixty (60) months, Lender will maintain policies

limiting dealer discretion in setting the contract rate to 75 basis points.[111] Lender may include in its policies an additional reasonable nondiscretionary component of dealer compensation, which is intended to continue to fairly compensate dealers.

b) Lender will maintain general compliance management systems to monitor for compliance with all federal consumer financial laws, including ECOA.

- This will include Lender sending regular notices to all dealers explaining the ECOA, stating Lender's expectation with respect to ECOA compliance, and articulating the dealer's obligation to price retail installment contracts in a non-discriminatory manner.

c) Moderate enhanced compliance management system; Lender will **not** be required to implement the robust enhanced CMS set forth in paragraph 3(c) below.

- Lender will maintain a fair lending monitoring program that includes portfolio-level annual review of the results of dealer discretion in setting the contract rate as to prohibited basis groups under ECOA using the Bureau/DOJ's methodology.
- If disparities of ten (10) basis points or more are identified in the portfolio-level annual review of dealer discretion in setting the contract rate as to any identified prohibited basis group, Lender must take proactive steps to lower those disparities, including further limiting dealer discretion in setting the contract rate or another intervention agreed upon by the parties.

d) Limited review and remuneration for prohibited basis disparities in dealer discretion identified in monitoring:

- If disparities of ten (10) basis points or more are **not** identified as to any identified prohibited basis group in the portfolio-level annual review of dealer discretion in setting the contract rate for two (2) consecutive years, then further portfolio-level annual review of dealer discretion in setting the contract rate will not be required for the remainder of the term of the consent order.
- If disparities of ten (10) basis points or more **are** identified as to any identified prohibited basis group in the portfolio-level annual review of dealer discretion in setting the contract rate for

[111] "Dealer discretion" includes the entire range of dealer deviation from Lender's risk-based buy rate, whether exercised by increasing or decreasing the buy rate. If we are unsuccessful in negotiating a two-tier cap on dealer markup, we seek in the alternative the discretion to negotiate a single 100 basis point cap for all loans.

two (2) consecutive years, Lender will remunerate all borrowers harmed in that group during that time period.

3. Discretionary dealer compensation and pricing policy at current limits on dealer discretion.

   a) Dealer discretion in setting the contract rate will be limited to Lender's current limits.

   b) Lender will maintain general compliance management systems to monitor for compliance with all federal consumer financial laws, including ECOA.

      - This will include Lender sending regular notices to all dealers explaining the ECOA, stating Lender's expectation with respect to ECOA compliance, and articulating the dealer's obligation to price retail installment contracts in a non-discriminatory manner.

   c) Robust enhanced compliance management system.

   - Lender will implement and maintain a robust compliance management system to identify and promptly remediate fair lending risk resulting from dealer discretion in setting the contract rate.

   - Lender will complete analysis of portfolio-level dealer discretion in setting the contract rate within thirty (30) days of the end of each calendar quarter and the end of each calendar year for disparities as to any identified prohibited basis group using the Bureau/DOJ's methodology.

      - If disparities of ten (10) basis points or more are identified (before any remuneration is made) in any portfolio-level annual review of dealer discretion in setting the contract rate as to any identified prohibited basis group, Lender must reduce its limit on dealer discretion by fifty (50) basis points prior to the commencement of the next calendar quarter. Basis point reductions will carry over and accumulate if disparities of ten (10) basis points or more are identified as to any identified prohibited basis group in multiple review periods.

   - Lender will complete analysis of dealer-level discretion in setting the contract rate within thirty (30) days of the end of each calendar quarter for disparities as to any identified prohibited basis group.

      - Lender must take corrective action within thirty (30) days with respect to dealers who are identified in the dealer-level quarterly analysis of dealer discretion is setting the contract rate to have ten (10) bps or more disparities as to any identified prohibited basis group. Such corrective action will

consist of either further limiting or eliminating the discretion of such dealers to set a consumer's contract rate or excluding dealers from future transactions with Lender; and remunerating affected consumers.

d) Review and remuneration for prohibited basis disparities in dealer discretion in setting the contract rate identified in monitoring:

- If disparities of ten (10) basis points or more are identified in any portfolio-level annual review of dealer discretion is setting the contract rate as to any identified prohibited basis group, Lender must remunerate harmed borrowers within sixty (60) days.

Although the first and third elements are similar to those ordered in *In the Matter of Ally Financial*, No. 2013-CFPB-0010 (Dec. 20, 2013), the requested settlement parameters seek authority to modify the components of the *Ally* injunctive relief, most notably adding a third option (the second listed), which relies on a lower cap on dealer discretion to reduce fair lending risk. In the event that we are unsuccessful in negotiating a settlement with one of these three options, we seek authority in the alternative to negotiate the same injunctive relief set forth in *In the Matter of Ally Financial*, No. 2013-CFPB-0010 (Dec. 20, 2013).

2. Remediation

We also seek authority to negotiate remediation to harmed borrowers for past consumer harm. The amount of remediation would be based on the following:

Honda:

- **Direct monetary damages in the range of *$13-$54* million (paid as money or as a note rate reduction) for loans originated between January 1, 2011 and December 31, 2013.** The upper figure represents the estimated overpayment over the full life of the loan for the estimated 253,663 affected consumers who borrowed from Honda during that time period. The lower figure accounts for two potential discounting factors. First, due to early repayment, the actual life of many loans is shorter than the full term of the loan. Depending on the rates of prepayment, this adjustment could significantly reduce the calculation of direct monetary damages. Second, when certain controls are included in the statistical analysis, the model reports lower markup disparities.[112] Applying controls that we may accept in negotiations, the lowest disparity calculated by the Bureau is 18 basis points. This discounting factor could potentially reduce the calculation of direct monetary damages by approximately half.

[112] The referenced controls include caps and dealer fixed effects.

Of note, to the extent that victims continue to hold their loans with Honda, we seek authorization to have Honda provide the monetary relief that relates to future loan payments through note rate reductions rather than through payment of damages.[113]

- **Direct monetary damages estimated to be in the range of *$4-$18* million (paid as money or as a note rate reduction) for loans originated between January 1, 2014 and December 31, 2014.** This figure is extrapolated from the estimated damages for the review period (see above), and assumes that approximately the same number of borrowers was harmed during the later period, to approximately the same extent. These working assumptions are based on the facts that the challenged policy and practice continued during the later period and that, based on its recent financial statements, Honda's indirect auto lending business has not expanded or contracted significantly during that period.

- **Indirect pecuniary and indirect non-pecuniary damages such as emotional distress damages for harmed consumers who borrowed from Honda between January 1, 2011 and December 31, 2013, up to *$25* million.** These numbers are based on DOJ precedent for calculating indirect damages in fair lending matters. Typically, the DOJ considers $500 per person as an appropriate estimate for indirect damages in the context of a mortgage loan. Given that this matter involves automobile loans rather than mortgages, Bureau staff reduced the estimated indirect damages to $150 per person. As a result, the top range represents $150 per person for each of the estimated 164,641 injured borrowers. The lower range reflects $0 per person, as we seek discretion not to include indirect damages in the settlement, depending on the agreed amount of direct damages.[114]

- **Indirect pecuniary and indirect non-pecuniary damages such as emotional distress damages for harmed consumers who borrowed from Honda from January 1, 2014 to December 31, 2014, up to *$8* million.** As discussed above, the operating assumption, until we obtain more data about Honda's indirect auto lending after December 31, 2013, is that approximately the same number of borrowers were affected by Honda's discriminatory markup during the later period, as compared with the review

[113] Should Bureau staff accept note rate reductions in lieu of monetary payments for future harm, the negotiated payment from the entity will be reduced accordingly.

[114] The *Ally* consent order did not distinguish between monetary and emotional distress damages. *See In the Matter of Ally Financial*, No. 2013-CFPB-0010 (Dec. 20, 2013), at 15. The consent order describes the $80 million in redress as "the amount of total consumer monetary and other damages" caused by Ally's practices. *Id*. The associated Supervisory Letter, which was incorporated by reference into the consent order, identified that of the $80 million in damages, $3 million represented indirect damages.

period. Using the same parameters as used for the review period, the top range of the estimated indirect damages for 2013 is based on $150 per person for approximately 54,880 injured borrowers. The lower range reflects $0 per person; as noted above, we seek discretion not to include indirect damages in the settlement, depending on the agreed amount of direct damages.

[redacted]

- **Direct monetary damages in the range of *$10-42* million (paid as money or as a note rate reduction) for loans originated between January 1, 2011 and December 31, 2013.**[115] The upper figure represents the estimated overpayment over the full life of the loan for the estimated 226,130 affected consumers who borrowed from [redacted] during that time period. The lower figure accounts for the same potential discounting factors as with Honda.

- **Direct monetary damages estimated to be in the range of *$4-14* million (paid as money or as a note rate reduction) for loans originated between January 1, 2014 and December 31, 2014.** This figure is extrapolated from the estimated damages for the review period (see above), and assumes that approximately the same number of borrowers was harmed during the later period, to approximately the same extent. These working assumptions are based on the facts that the challenged policy and practice continued during the later period and that, based on its recent financial statements, [redacted] indirect auto lending business has not expanded or contracted significantly during that period.

- **Indirect pecuniary and indirect non-pecuniary damages such as emotional distress damages for harmed consumers who borrowed from [redacted] between January 1, 2011 and December 31, 2013, up to *$19* million.** The top range represents $150 per person for each of the estimated 127,285 injured borrowers. The lower range reflects $0 per person, as we seek discretion not to include indirect damages in the settlement, depending on the agreed amount of direct damages.

- **Indirect pecuniary and indirect non-pecuniary damages such as emotional distress damages for harmed consumers who borrowed from [redacted] from January 1, 2014 to December 31, 2014, up to *$7* million.** As discussed above, the operating assumption, until we obtain more data about [redacted] indirect auto lending after December 31, 2013, is that approximately the same number of borrowers were affected by [redacted] discriminatory markup during the later period, as compared with the review

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[115] To the extent [redacted] has remunerated certain consumers in part, those payments would offset these payments.

period. Using the same parameters as used for the review period, the top range of the estimated indirect damages for 2013 is based on $150 per person for approximately 42,428 injured borrowers. The lower range reflects $0 per person; as noted above, we seek discretion not to include indirect damages in the settlement, depending on the agreed amount of direct damages.

[REDACTED]:

- **Direct monetary damages in the range of *$6-22* million (paid as money or as a note rate reduction) for loans originated between January 1, 2011 and December 31, 2013.** The upper figure represents the estimated overpayment over the full life of the loan for the estimated 101,605 affected consumers who borrowed from [REDACTED] during that time period. The lower figure accounts for the same potential discounting factors as with Honda and [REDACTED].

- **Direct monetary damages estimated to be in the range of *$2-8* million (paid as money or as a note rate reduction) for loans originated between January 1, 2014 and December 31, 2014.** This figure is extrapolated from the estimated damages for the review period (see above), and assumes that approximately the same number of borrowers was harmed during the later period, to approximately the same extent. These working assumptions are based on the facts that the challenged policy and practice continued during the later period and that, based on its recent financial statements, [REDACTED] indirect auto lending business has not expanded significantly during that period.

  In addition, we note one potentially significant difference between the review period (2011-2013) and the later period (2014): [REDACTED] lowered its markup cap to [REDACTED] basis points during the course of 2014. We can assume that the relationship between lower caps and disparities was positive. That is, as [REDACTED] lowered the cap on its dealer markups, it likely shrank the markup disparities. This factor would tend to lead to lower direct damages for the later period, compared with the review period.

- **Indirect pecuniary and indirect non-pecuniary damages such as emotional distress damages for harmed consumers who borrowed from Honda and [REDACTED] between January 1, 2011 and December 31, 2013, up to *$11* million.** The top range represents $150 per person for each of the estimated 74,405 injured borrowers. The lower range reflects $0 per person, as we seek discretion not to include indirect damages in the settlement, depending on the agreed amount of direct damages.

- **Indirect pecuniary and indirect non-pecuniary damages such as emotional distress damages for harmed consumers who borrowed from Honda and [REDACTED] from January 1, 2014 to December 31, 2014, up to *$4* million.** As discussed above, the operating assumption,

until we obtain more data about [redacted] indirect auto lending after December 31, 2013, is that approximately the same number of borrowers were affected by [redacted] discriminatory markup during the later period, as compared with the review period. Using the same parameters as used for the review period, the top range of the estimated indirect damages for 2014 is based on $150 per person for approximately 24,801 injured borrowers. The lower range reflects $0 per person; as noted above, we seek discretion not to include indirect damages in the settlement, depending on the agreed amount of direct damages.

Based on these estimates, the amount of borrower relief could be as high as *$232* million. While Bureau staff believes there is a sufficient basis for seeking up to *$232* million in damages, we seek authority to settle for as low as *$39* million in consumer damages, to account for litigation risk and other potential counterarguments from the captives. As noted above, we expect to settle in the range of *$55-$86* million. In particular, we expect that the captives will show that a significant number of borrowers prepaid their loans, reducing the monetary harm they suffered as a result of the alleged violations. Thus, that factor is likely to result in a lower settlement.

In order to efficiently and effectively distribute these funds to harmed borrowers, we also seek authority to negotiate a methodology for remunerating borrowers, although as in *Ally*, our preference would be to require a settlement administrator so that this issue will be determined at a later date. Based upon our colleagues' conversations with experienced outside economists, several options exist, including:

1. Contacting all potentially harmed borrowers and requesting them to identify their race and/or national origin and distributing damages based on that self-identification;
2. Assigning race and national origin using thresholds and distributing damages based on those assignments[116]; or
3. Using a hybrid approach that combines a threshold determination with self-identification by potentially-affected borrowers, which could be accomplished either by requiring borrowers to opt-in (i.e., by taking affirmation action to obtain relief) or opt-out (*i.e.*, borrowers would receive relief unless they opt not to).[117]

We also seek authority to negotiate, in our discretion, whether to allow Honda, [redacted], and [redacted] to administer the relief or require the use of a third party administrator.

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[116] This is the approach that has been used in supervisory resolutions of similar claims.

[117] This is the approach currently being employed in the *Ally* matter.

3. Civil Money Penalties

Any person who violates a Federal consumer financial law may be required to pay a civil money penalty. 12 U.S.C. § 5565(c). The Consumer Financial Protection Act (CFPA) provides for three tiers of penalties depending upon the nature of the conduct at issue—up to $5,000 per day for any violation regardless of the violator's knowledge (Tier 1); up to $25,000 per day for recklessly engaging in a violation (Tier 2); and up to $1,000,000 per day for a knowing violation (Tier 3). 12 U.S.C. § 5565(c)(2).

Under 12 U.S.C. § 5565(c)(3), the Bureau must also consider the following factors to determine an appropriate penalty:

(1) the Bank's financial resources and any demonstrated good faith;
(2) the gravity of the violation or failure to pay;
(3) the severity of the risks to or losses of the consumer, which may take into account the number of products or services sold or provided;
(4) the Bank's history of previous violations; and
(5) such other matters as justice may require.

Based on these factors, Bureau staff believes that a penalty of approximately $0-30 million for Honda, $0-20 million for [redacted], and $0-30 million for [redacted] is appropriate here.

First, Honda, [redacted], and [redacted] were each on sufficient notice of the fair lending risks inherent in their indirect auto lending portfolios, having been defendants in prior litigation on this very same issue, putting them in the higher tiers of civil money penalties. At all times since January 1, 2011, these entities had the data and information needed to assess their own fair lending compliance and uncover the violations described herein, but did not conduct such analysis. Although [redacted] has now implemented a monitoring program, that program was not in place until well into the Bureau's investigation.

Second, [redacted], Honda, and [redacted] are the [redacted], [redacted], and [redacted] largest auto lenders, respectively. During the three-year time period of the Bureau's fair lending review, [redacted] originated [redacted] indirect auto loans. For the two-year period 2011-2012,[118] Honda originated [redacted] indirect automobile loans of which 404,679 were non-subvented and 826,021 were subvented loans. Honda originated an additional 233,098 non-subvented loans in 2013. During the three-year time period, [redacted] originated [redacted] indirect auto loans.

Third, the entities' disparities are substantial. Honda's markup disparities are among the most egregious of the entities examined by the Bureau. No nonbank captive lender had higher average disparities for African-American, Hispanic, and Asian and/or Pacific Islander borrowers. Moreover, the harm was widespread: the disparities

[118] Honda did not specify how many subvented loans it made in 2013.

occurred across Honda's portfolio of indirect auto loans and harmed over 164,641 African-American, Hispanic, and Asian and/or Pacific Islander borrowers from 2011 through 2013, plus an undetermined but likely similarly large number in 2014. had significant disparities, consistent with those seen at Ally for African-Americans and Asian and/or Pacific Islanders, with harm to 127,285 consumers for the period 2011-2013, plus an undetermined but likely similarly large number in 2014. likewise had lesser, although significant, disparities for African-American and Hispanic borrowers, harming 74,405 consumers during the period 2011-2013, plus an undetermined number in 2014.

Fourth, Honda has failed to take corrective action for its actions. Although has not demonstrated independent good faith in conducting its own internal fair lending reviews, it has lowered its cap to . Of the three, only has engaged in good faith activities to stand up a compliance program and remunerate harmed consumers prior to being notified of any potential enforcement action.

Fifth, the proposed penalty is of sufficient magnitude to represent a strong deterrent but not jeopardize the viability of the companies. The alleged conduct is illegal discrimination on the basis of race and national origin that harmed tens of thousands of consumers, which are very serious violations. Bureau staff believes that the proposed ranges reflect that seriousness.

Finally, a civil money penalty of $0-30 million for Honda, $0-20 for , and $0-30 for would be consistent with past Bureau precedent. The *Ally* settlement, for instance, imposed a civil money penalty of $18 million.[119] In *Ally*, the average markup disparities fell between Honda and disparities. As noted above, , Honda, and are the , , and largest auto lenders, respectively, and Ally is the second largest. The Bureau's recent credit card settlements are also instructive. In the 2012 settlement with American Express for illegal credit card practices including age discrimination, the Bureau ordered the company to pay $14.1 million in civil money penalties.[120] In the Bureau's cases involving credit card add-on products, the Bureau ordered penalties of $25 million against Capital One;[121] $20 million against Chase;[122]

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[119] Consent Order, *In the Matter of Ally Financial*, No. 2013-CFPB-0010 (Dec. 20, 2013), at 20.

[120] Consent Order, *In the Matter of American Express Centurion Bank*, No. 2012-CFPB-0002 (Oct. 1, 2012) ($3.9 million); Consent Order, *In the Matter of American Express Bank, FSB*, No. 2012-CFPB-0003 (Oct. 1, 2012) ($1.2 million); Consent Order, *In the Matter of American Express Travel Related Services Co.*, No. 2012-CFPB-0004 (Oct. 1, 2012) ($9 million). The three consent orders are available at: http://www.consumerfinance.gov/newsroom/cfpb-orders-american-express-to-pay-85-million-refund-to-consumers-harmed-by-illegal-credit-card-practices/.

[121] Consent Order, *In the Matter of Capital One Bank*, 2012-CFPB-0001 (July 18, 2012), available at http://files.consumerfinance.gov/f/201207_cfpb_consent_order_0001.pdf.

$14 million against Discover;[123] and an additional $9.6 million against American Express.[124] In each case, the companies paid the penalties in addition to remediation to affected consumers.

Additionally, while we believe it is appropriate to negotiate for as much as $30 million in civil money penalties against Honda, $20 million against [redacted], and $30 million against [redacted], we would be willing to forgo civil money penalties against any entity that opted for an alternative to discretionary dealer compensation at its current caps, including for example, adopting nondiscretionary dealer compensation or adopting a 100 bps cap as proposed. We believe that adoption of such alternatives would constitute responsible conduct that would effectively reduce fair lending risk and hence warrant the Bureau not seeking a penalty.

4. Ability to Pay

Based on its 2015 Q1 10-Q, Honda has the ability to pay for the remediation and civil money penalties that we will be demanding in this matter. In that quarter alone (three month period ended June 30, 2014), Honda had a net income of $276 million. Based on [redacted] has the ability to pay for the remediation and civil money penalties that we will be demanding in this matter. [redacted] We anticipate that [redacted] has the ability to pay. [redacted]

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[122] Consent Order, *In the Matter of JPMorgan Chase*, 2013-CFPB-0007 (Sept. 19, 2013), available at http://files.consumerfinance.gov/f/201309_cfpb_jpmc_consent-order.pdf.

[123] Joint Consent Order, *In the Matter of Discover Bank*, 2012-CFPB-0005 (Sept. 24, 2012), available at http://files.consumerfinance.gov/f/201209_cfpb_consent_order_0005.pdf. The penalty in this case was jointly imposed by the FDIC and the Bureau.

[124] Consent Order, *In the Matter of American Express Centurion Bank*, No. 2013-CFPB-0011 (Dec. 24, 2013) ($3.6 million); Consent Order, *In the Matter of American Express Bank, FSB*, No. 2013-CFPB-0012 (Dec. 24, 2013) ($2 million); Consent Order, *In the Matter of American Express Travel Related Services Co.*, No. 2013-CFPB-0013 (Dec. 24, 2013) ($4 million). The three consent orders are available at: http://www.consumerfinance.gov/newsroom/cfpb-orders-american-express-to-pay-59-5-million-for-illegal-credit-card-practices/.

[125] [redacted]

VI. ASSESSMENT OF RISKS OF THE RECOMMENDED APPROACH

As indicated above, this matter presents litigation risks, in particular the use of proxying and reliance on the disparate impact doctrine. Although the Bureau has taken a public position on its use of the proxy methodology,[126] neither the Bureau nor the DOJ has litigated its use in an ECOA matter. As the cases mentioned above indicate, there are federal court decisions coming down for and against the use of proxies, though most cases are positive. Bureau staff's assessment is that the Bureau's Office of Research has spent considerable time vetting its methodology and that the method, which was followed by BLDS in conducting its analyses, is sufficiently accurate to be used to support both negotiation and litigation.

The anticipated arguments that these entities are not creditors under the ECOA are not particularly strong in view of contrary case law. However, arguments regarding disparate impact liability and the Supreme Court's decision in *Dukes* are untested. There is little applicable case law regarding a government enforcement action on facts similar to *Dukes* since that decision, and while there are bases to distinguish *Dukes*, plaintiffs have consistently been unable to obtain class certification in cases challenging discretionary broker pricing, which are quite analogous to this matter. In addition, as noted above, the recent amended memorandum decision in *American Insurance Assoc. v. HUD*, No. 13-00966 (RJL) (Nov.7, 2014), as well as the Supreme Court's granting of certiorari in *Texas Dep't of Housing and Community Affairs v. The Inclusive Communities Project, Inc.*, No. 13-1371, -- S. Ct. ---, 2014 WL 4916193 (Oct. 2, 2014), may embolden the defense bar's challenges to disparate impact liability under not only the FHA, but also the ECOA. Nonetheless, consistent with the Bureau's April 2012 Lending Discrimination Bulletin, we recommend continuing to enforce disparate impact liability under the ECOA, even if it requires litigation.

Although these have been joint Bureau /DOJ investigations, the Bureau is required to refer this matter to the DOJ. We understand that the DOJ is simultaneously seeking authority to sue these entities. Thus, based on our experience in the *Ally* matter, in order to avoid having to seek additional authority mid-negotiation, we are requesting such authority now.

In comparison to the other entities in the bank and nonbank indirect automobile lending initiative, Honda, [redacted], and [redacted] demonstrated relatively high disparities in dealer markups (Honda was higher than *Ally*, [redacted] and [redacted] slightly lower) and the

[126] *See* CFPB, *Using Publicly Available Information to Proxy for Unidentified Race and Ethnicity: A Methodology and Assessment* (Sept. 17, 2014), *available at* http://www.consumerfinance.gov/reports/using-publicly-available-information-to-proxy-for-unidentified-race-and-ethnicity/.; Ficklin, Patrice, Consumer Financial Protection Bureau blog, "Preventing illegal discrimination in auto lending," (November 4, 2013), *available at* http://www.consumerfinance.gov/blog/preventing-illegal-discrimination-in-auto-lending/ (last checked January 24, 2014).

highest harm per borrower. Bureau staff believe that these cases have good facts and a reasonable expectation of success in obtaining settlement. It is reasonable to conclude that Honda, [redacted], and [redacted] recognize the legal and reputational risks of engaging in protracted litigation and will want to negotiate. Should such negotiations break down, Bureau staff's assessment is that the Bureau would have a reasonable likelihood of success in litigation at the district court level, particularly if joined by the DOJ. We would note, however, that given the recent litigation of disparate impact under the FHA, defense counsel may be emboldened to appeal this issue under ECOA.

VII. CONCLUSION

Bureau staff seeks settlement authority for $17-$105 million to address consumer harm against Honda, $14-$82 million to address consumer harm against [redacted]; and $15-$44 million to address consumer against [redacted]. These ranges represent a realistic assessment of the Bureau's analysis of Honda, [redacted] and [redacted] data, and litigation risk. In addition, Bureau staff seeks settlement authority for $0-$30 million civil money penalties against Honda, $0-20 million civil money penalties against [redacted], and $0-$30 million civil money penalties against [redacted]. These ranges take into account the factors set forth in the CFPA, § 1055. Overall, settlement in the aggregate monetary ranges will provide substantial remediation to harmed borrowers and impose a significant civil money penalty on the alleged violator if it is deemed appropriate in the course of negotiations. Bureau staff also seek authority to negotiate appropriate injunctive relief, including an enhanced fair lending compliance management system or the adoption of an alternative dealer compensation program that either eliminates or substantially reduces dealer discretion. Should negotiations fail, Bureau staff seek authority to commence litigation against Honda, [redacted], and [redacted] for violations of the ECOA and Regulation B.

Attachments

Attachment A: Honda Proposed Term Sheet
Attachment B: [redacted] Proposed Term Sheet
Attachment C: [redacted] Proposed Term Sheet
Attachment D: Draft Honda Complaint
Attachment E: Draft [redacted] Complaint
Attachment F: Draft [redacted] Complaint

Attachment A: HONDA TERM SHEET
(Summary of Proposed Settlement Parameters)

As detailed in the foregoing memorandum, Bureau staff seeks authority to negotiate a settlement with Honda in this matter within the following parameters:

A. Injunctive relief to correct the identified ECOA violations and prevent future ECOA violations, including:

1. Nondiscretionary dealer compensation and pricing policy.
    a) Lender will maintain policies that do not allow dealers any discretion to set the contract rate.
    b) Lender will maintain general compliance management systems to monitor for compliance with all federal consumer financial laws, including ECOA.
        - This will include Lender sending regular notices to all dealers explaining the ECOA, stating Lender's expectation with respect to ECOA compliance, and articulating the dealer's obligation to price retail installment contracts in a non-discriminatory manner.
    c) Lender will **not** be required to implement enhanced compliance management systems set forth in paragraphs 2(c) and 3(c) below.
    d) Lender will **not** have to review or remunerate for prohibited basis disparities resulting from dealer discretion in setting the contract rate, because there is no such discretion.
2. Dealer compensation and pricing policy with more limited dealer discretion.
    a) For retail installment contracts with a term of sixty (60) months or less, Lender will maintain policies limiting dealer discretion in setting the contract rate to 100 bps, and for retail installment contracts with a term greater than sixty (60) months, Lender will maintain policies limiting dealer discretion in setting the contract rate to 75 basis points.
    b) [1] Lender may include in its policies an additional reasonable nondiscretionary component of dealer compensation, which is intended to continue to fairly compensate dealers.
    c) Lender will maintain general compliance management systems to monitor for compliance with all federal consumer financial laws, including ECOA.

[1] "Dealer discretion" includes the entire range of dealer deviation from Lender's risk-based buy rate, whether exercised by increasing or decreasing the buy rate. If we are unsuccessful in negotiating a two-tier cap on dealer markup, we seek in the alternative the discretion to negotiate a single 100 basis point cap for all loans.

- This will include Lender sending regular notices to all dealers explaining the ECOA, stating Lender's expectation with respect to ECOA compliance, and articulating the dealer's obligation to price retail installment contracts in a non-discriminatory manner.

d) Moderate enhanced compliance management system; Lender will **not** be required to implement the robust enhanced CMS set forth in paragraph 3(c) below.

- Lender will maintain a fair lending monitoring program that includes portfolio-level annual review of the results of dealer discretion in setting the contract rate as to prohibited basis groups under ECOA using the Bureau/DOJ's methodology.
- If disparities of ten (10) basis points or more are identified in the portfolio-level annual review of dealer discretion in setting the contract rate as to any identified prohibited basis group, Lender must take proactive steps to lower those disparities, including further limiting dealer discretion in setting the contract rate or another intervention agreed upon by the parties.

e) Limited review and remuneration for prohibited basis disparities in dealer discretion identified in monitoring:

- If disparities of ten (10) basis points or more are **not** identified as to any identified prohibited basis group in the portfolio-level annual review of dealer discretion in setting the contract rate for two (2) consecutive years, then further portfolio-level annual review of dealer discretion in setting the contract rate will not be required for the remainder of the term of the consent order.
- If disparities of ten (10) basis points or more **are** identified as to any identified prohibited basis group in the portfolio-level annual review of dealer discretion in setting the contract rate for two (2) consecutive years, Lender will remunerate all borrowers harmed in that group during that time period.

3. Discretionary dealer compensation and pricing policy at current limits on dealer discretion.

a) Dealer discretion in setting the contract rate will be limited to Lender's current limits.

b) Lender will maintain general compliance management systems to monitor for compliance with all federal consumer financial laws, including ECOA.

- This will include Lender sending regular notices to all dealers explaining the ECOA, stating Lender's expectation with respect to ECOA compliance, and articulating the dealer's obligation to

price retail installment contracts in a non-discriminatory manner.

c) Robust enhanced compliance management system.

- Lender will implement and maintain a robust compliance management system to identify and promptly remediate fair lending risk resulting from dealer discretion in setting the contract rate.
- Lender will complete analysis of portfolio-level dealer discretion in setting contract rate within thirty (30) days of the end of each calendar quarter and the end of each calendar year for disparities as to any identified prohibited basis group using the Bureau/DOJ's methodology.
  - If disparities of ten (10) basis points or more are identified (before any remuneration is made) in any portfolio-level annual review of dealer discretion in setting the contract rate as to any identified prohibited basis group, Lender must reduce its limit on dealer discretion by fifty (50) basis points prior to the commencement of the next calendar quarter. Basis point reductions will carry over and accumulate if disparities of ten (10) basis points or more are identified as to any identified prohibited basis group in multiple review periods.
- Lender will complete analysis of dealer-level discretion in setting the contract rate within thirty (30) days of the end of each calendar quarter for disparities as to any identified prohibited basis group.
  - Lender must take corrective action within thirty (30) days with respect to dealers who are identified in the dealer-level quarterly analysis of dealer discretion in setting the contract rate to have ten (10) bps or more disparities as to any identified prohibited basis group. Such corrective action will consist of either further limiting or eliminating the discretion of such dealers to set a consumer's contract rate or excluding dealers from future transactions with Lender; and remunerating affected consumers.

d) Review and remuneration for prohibited basis disparities in dealer discretion in setting the contract rate identified in monitoring:

- If disparities of ten (10) basis points or more are identified in any portfolio-level annual review of dealer discretion is setting the contract rate as to any identified prohibited basis group,

Lender must remunerate harmed borrowers within sixty (60) days.[2]

B. Remediation to harmed borrowers in the range of $17 to $105 million, to address the monetary and non-monetary harms they suffered, including:

a) Direct monetary damages in the range of $13 to $54 million (paid as money or as a note rate reduction) for loans originated between January 1, 2011 and December 31, 2013;

b) Direct monetary damages estimated to be in the range of $4 to $18 million (paid as money or as a note rate reduction) for loans originated between January 1, 2014 and December 31, 2014;

c) Indirect damages for harmed consumers who borrowed from Honda between January 1, 2011 and December 31, 2013, up to $25 million; and

d) Indirect damages for harmed consumers who borrowed from Honda from January 1, 2014 to December 31, 2014, up to $8 million.

In addition, Bureau staff seeks authority to negotiate, in its discretion, an appropriate method of identifying harmed borrowers, determining the amount of their remediation, and distributing the funds. Bureau staff also seeks authority to negotiate, in its discretion, whether to allow Honda to administer the relief itself or to require the use of a third party administrator.

C. Civil Money Penalties from $0-30 million.

[2] In the event that we are unsuccessful in negotiating a settlement with one of these three options, we seek authority in the alternative to negotiate the same injunctive relief set forth in *In the Matter of Ally Financial*, No. 2013-CFPB-0010 (Dec. 20, 2013).

Attachment B: [redacted] TERM SHEET (Summary of Proposed Settlement Parameters)

As detailed in the foregoing memorandum, Bureau staff seeks authority to negotiate a settlement with [redacted] in this matter within the following parameters:

A. Injunctive relief to correct the identified ECOA violations and prevent future ECOA violations, including:

1. Nondiscretionary dealer compensation and pricing policy.
   - a) Lender will maintain policies that do not allow dealers any discretion to set the contract rate.
   - b) Lender will maintain general compliance management systems to monitor for compliance with all federal consumer financial laws, including ECOA.
     - This will include Lender sending regular notices to all dealers explaining the ECOA, stating Lender's expectation with respect to ECOA compliance, and articulating the dealer's obligation to price retail installment contracts in a non-discriminatory manner.
   - c) Lender will **not** be required to implement enhanced compliance management systems set forth in paragraphs 2(c) and 3(c) below.
   - d) Lender will **not** have to review or remunerate for prohibited basis disparities resulting from dealer discretion in setting the contract rate, because there is no such discretion.
2. Dealer compensation and pricing policy with more limited dealer discretion.
   - a) For retail installment contracts with a term of sixty (60) months or less, Lender will maintain policies limiting dealer discretion in setting the contract rate to 100 bps, and for retail installment contracts with a term greater than sixty (60) months, Lender will maintain policies limiting dealer discretion in setting the contract rate to 75 basis points.[1] Lender may include in its policies an additional reasonable nondiscretionary component of dealer compensation, which is intended to continue to fairly compensate dealers.
   - b) Lender will maintain general compliance management systems to monitor for compliance with all federal consumer financial laws, including ECOA.

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[1] "Dealer discretion" includes the entire range of dealer deviation from Lender's risk-based buy rate, whether exercised by increasing or decreasing the buy rate. If we are unsuccessful in negotiating a two-tier cap on dealer markup, we seek in the alternative the discretion to negotiate a single 100 basis point cap for all loans.

- This will include Lender sending regular notices to all dealers explaining the ECOA, stating Lender's expectation with respect to ECOA compliance, and articulating the dealer's obligation to price retail installment contracts in a non-discriminatory manner.

c) Moderate enhanced compliance management system; Lender will **not** be required to implement the robust enhanced CMS set forth in paragraph 3(c) below.

- Lender will maintain a fair lending monitoring program that includes portfolio-level annual review of the results of dealer discretion in setting the contract rate as to prohibited basis groups under ECOA using the Bureau/DOJ's methodology.
- If disparities of ten (10) basis points or more are identified in the portfolio-level annual review of dealer discretion in setting the contract rate as to any identified prohibited basis group, Lender must take proactive steps to lower those disparities, including further limiting dealer discretion in setting the contract rate or another intervention agreed upon by the parties.

d) Limited review and remuneration for prohibited basis disparities in dealer discretion identified in monitoring:

- If disparities of ten (10) basis points or more are **not** identified as to any identified prohibited basis group in the portfolio-level annual review of dealer discretion in setting the contract rate for two (2) consecutive years, then further portfolio-level annual review of dealer discretion in setting the contract rate will not be required for the remainder of the term of the consent order.
- If disparities of ten (10) basis points or more **are** identified as to any identified prohibited basis group in the portfolio-level annual review of dealer discretion in setting the contract rate for two (2) consecutive years, Lender will remunerate all borrowers harmed in that group during that time period.

3. Discretionary dealer compensation and pricing policy at current limits on dealer discretion.

a) Dealer discretion in setting the contract rate will be limited to Lender's current limits.

b) Lender will maintain general compliance management systems to monitor for compliance with all federal consumer financial laws, including ECOA.

- This will include Lender sending regular notices to all dealers explaining the ECOA, stating Lender's expectation with respect to ECOA compliance, and articulating the dealer's obligation to

price retail installment contracts in a non-discriminatory manner.

c) Robust enhanced compliance management system.

- Lender will implement and maintain a robust compliance management system to identify and promptly remediate fair lending risk resulting from dealer discretion in setting the contract rate.
- Lender will complete analysis of portfolio-level dealer discretion in setting the contract rate within thirty (30) days of the end of each calendar quarter and the end of each calendar year for disparities as to any identified prohibited basis group using the Bureau/DOJ's methodology.
  - If disparities of ten (10) basis points or more are identified (before any remuneration is made) in any portfolio-level annual review of dealer discretion in setting the contract rate as to any identified prohibited basis group, Lender must reduce its limit on dealer discretion by fifty (50) basis points prior to the commencement of the next calendar quarter. Basis point reductions will carry over and accumulate if disparities of ten (10) basis points or more are identified as to any identified prohibited basis group in multiple review periods.
- Lender will complete analysis of dealer-level discretion in setting the contract rate within thirty (30) days of the end of each calendar quarter for disparities as to any identified prohibited basis group.
  - Lender must take corrective action within thirty (30) days with respect to dealers who are identified in the dealer-level quarterly analysis of dealer discretion is setting the contract rate to have ten (10) bps or more disparities as to any identified prohibited basis group. Such corrective action will consist of either further limiting or eliminating the discretion of such dealers to set a consumer's contract rate or excluding dealers from future transactions with Lender; and remunerating affected consumers.

d) Review and remuneration for prohibited basis disparities in dealer discretion in setting the contract rate identified in monitoring:

- If disparities of ten (10) basis points or more are identified in any portfolio-level annual review of dealer discretion is setting the contract rate as to any identified prohibited basis group,

Lender must remunerate harmed borrowers within sixty (60) days.[2]

B. Remediation to harmed borrowers in the range of $14 to $82 million, to address the monetary and non-monetary harms they suffered, including:

a) Direct monetary damages in the range of $10 to $42 million (paid as money or as a note rate reduction) for loans originated between January 1, 2011 and December 31, 2013;

b) Direct monetary damages estimated to be in the range of $4 to $14 million (paid as money or as a note rate reduction) for loans originated between January 1, 2014and December 31, 2014;

c) Indirect damages for harmed consumers who borrowed from [redacted] between January 1, 2011 and December 31, 2013, up to $19 million; and

d) Indirect damages for harmed consumers who borrowed from [redacted] from January 1, 2014 to December 31, 2014, up to $7 million.

In addition, Bureau staff seek authority to negotiate, in its discretion, an appropriate method of identifying harmed borrowers, determining the amount of their remediation, and distributing the funds. Bureau staff also seek authority to negotiate, in its discretion, whether to allow [redacted] to administer the relief itself or to require the use of a third party administrator.

C. Civil money penalties from $0-$20 million.

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[2] In the event that we are unsuccessful in negotiating a settlement with one of these three options, we seek authority in the alternative to negotiate the same injunctive relief set forth in *In the Matter of Ally Financial*, No. 2013-CFPB-0010 (Dec. 20, 2013).

Attachment C: [redacted] TERM SHEET (Summary of Proposed Settlement Parameters)

As detailed in the foregoing memorandum, Bureau staff seeks authority to negotiate a settlement with [redacted] in this matter within the following parameters:

A. Injunctive relief to correct the identified ECOA violations and prevent future ECOA violations, including:

1. Nondiscretionary dealer compensation and pricing policy.
   a) Lender will maintain policies that do not allow dealers any discretion to set the contract rate.
   b) Lender will maintain general compliance management systems to monitor for compliance with all federal consumer financial laws, including ECOA.
      - This will include Lender sending regular notices to all dealers explaining the ECOA, stating Lender's expectation with respect to ECOA compliance, and articulating the dealer's obligation to price retail installment contracts in a non-discriminatory manner.
   c) Lender will **not** be required to implement enhanced compliance management systems set forth in paragraphs 2(c) and 3(c) below.
   d) Lender will **not** have to review or remunerate for prohibited basis disparities resulting from dealer discretion in setting the contract rate, because there is no such discretion.
2. Dealer compensation and pricing policy with more limited dealer discretion.
   a) For retail installment contracts with a term of sixty (60) months or less, Lender will maintain policies limiting dealer discretion in setting the contract rate to 100 bps, and for retail installment contracts with a term greater than sixty (60) months, Lender will maintain policies limiting dealer discretion in setting the contract rate to 75 basis points.[1] Lender may include in its policies an additional reasonable nondiscretionary component of dealer compensation, which is intended to continue to fairly compensate dealers.
   b) Lender will maintain general compliance management systems to monitor for compliance with all federal consumer financial laws, including ECOA.

[1] "Dealer discretion" includes the entire range of dealer deviation from Lender's risk-based buy rate, whether exercised by increasing or decreasing the buy rate. If we are unsuccessful in negotiating a two-tier cap on dealer markup, we seek in the alternative the discretion to negotiate a single 100 basis point cap for all loans.

- This will include Lender sending regular notices to all dealers explaining the ECOA, stating Lender's expectation with respect to ECOA compliance, and articulating the dealer's obligation to price retail installment contracts in a non-discriminatory manner.

c) Moderate enhanced compliance management system; Lender will **not** be required to implement the robust enhanced CMS set forth in paragraph 3(c) below.

- Lender will maintain a fair lending monitoring program that includes portfolio-level annual review of the results of dealer discretion in setting the contract rate as to prohibited basis groups under ECOA using the Bureau/DOJ's methodology.
- If disparities of ten (10) basis points or more are identified in the portfolio-level annual review of dealer discretion in setting the contract rate as to any identified prohibited basis group, Lender must take proactive steps to lower those disparities, including further limiting dealer discretion in setting the contract rate or another intervention agreed upon by the parties.

d) Limited review and remuneration for prohibited basis disparities in dealer discretion identified in monitoring:

- If disparities of ten (10) basis points or more are **not** identified as to any identified prohibited basis group in the portfolio-level annual review of dealer discretion in setting the contract rate for two (2) consecutive years, then further portfolio-level annual review of dealer discretion in setting the contract rate will not be required for the remainder of the term of the consent order.
- If disparities of ten (10) basis points or more **are** identified as to any identified prohibited basis group in the portfolio-level annual review of dealer discretion in setting the contract rate for two (2) consecutive years, Lender will remunerate all borrowers harmed in that group during that time period.

3. Discretionary dealer compensation and pricing policy at current limits on dealer discretion.

a) Dealer discretion in setting the contract rate will be limited to Lender's current limits.

b) Lender will maintain general compliance management systems to monitor for compliance with all federal consumer financial laws, including ECOA.

- This will include Lender sending regular notices to all dealers explaining the ECOA, stating Lender's expectation with respect to ECOA compliance, and articulating the dealer's obligation to

price retail installment contracts in a non-discriminatory manner.

c) Robust enhanced compliance management system.

- Lender will implement and maintain a robust compliance management system to identify and promptly remediate fair lending risk resulting from dealer discretion in setting the contract rate.
- Lender will complete analysis of portfolio-level dealer discretion in setting the contract rate within thirty (30) days of the end of each calendar quarter and the end of each calendar year for disparities as to any identified prohibited basis group using the Bureau/DOJ's methodology.
  - If disparities of ten (10) basis points or more are identified (before any remuneration is made) in any portfolio-level annual review of dealer discretion in setting the contract rate as to any identified prohibited basis group, Lender must reduce its limit on dealer discretion by fifty (50) basis points prior to the commencement of the next calendar quarter. Basis point reductions will carry over and accumulate if disparities of ten (10) basis points or more are identified as to any identified prohibited basis group in multiple review periods.
- Lender will complete analysis of dealer-level discretion in setting the contract rate within thirty (30) days of the end of each calendar quarter for disparities as to any identified prohibited basis group.
  - Lender must take corrective action within thirty (30) days with respect to dealers who are identified in the dealer-level quarterly analysis of dealer discretion is setting the contract rate to have ten (10) bps or more disparities as to any identified prohibited basis group. Such corrective action will consist of either further limiting or eliminating the discretion of such dealers to set a consumer's contract rate or excluding dealers from future transactions with Lender; and remunerating affected consumers.

d) Review and remuneration for prohibited basis disparities in dealer discretion in setting the contract rate identified in monitoring:

- If disparities of ten (10) basis points or more are identified in any portfolio-level annual review of dealer discretion is setting the contract rate as to any identified prohibited basis group,

Lender must remunerate harmed borrowers within sixty (60) days.[2]

B. Remediation to harmed borrowers in the range of $8 to $45 million, to address the monetary and non-monetary harms they suffered, including:

a) Direct monetary damages in the range of $6 to $22 million (paid as money or as a note rate reduction) for loans originated between January 1, 2011 and December 31, 2013;

b) Direct monetary damages estimated to be in the range of $2 to $8 million (paid as money or as a note rate reduction) for loans originated between January 1, 2014 and December 31, 2014;

c) Indirect damages for harmed consumers who borrowed from [redacted] between January 1, 2011 and December 31, 2013, up to $11 million; and

d) Indirect damages for harmed consumers who borrowed from [redacted] from January 1, 2014 to December 31, 2014, up to $4 million.

In addition, Bureau staff seek authority to negotiate, in its discretion, an appropriate method of identifying harmed borrowers, determining the amount of their remediation, and distributing the funds. Bureau staff also seek authority to negotiate, in its discretion, whether to allow [redacted] to administer the relief itself or to require the use of a third party administrator.

C. Civil money penalties from $0-$30 million.

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[2] In the event that we are unsuccessful in negotiating a settlement with one of these three options, we seek authority in the alternative to negotiate the same injunctive relief set forth in *In the Matter of Ally Financial*, No. 2013-CFPB-0010 (Dec. 20, 2013).