



Consumer Financial Protection Bureau

1700 G Street, N.W., Washington, DC 20552

MEMORANDUM

TO: [REDACTED], NER Senior Examination Manager and [REDACTED], NER Field Manager

FROM: [REDACTED], Senior Counsel, Fair Lending Office

RE: [REDACTED] Indirect Auto MOU Compliance – Forward-Looking Remediation

DATE: 06/26/2015

I. Background

On March 19, 2014, [REDACTED] entered into a memorandum of understanding (MOU) with the CFPB regarding the corrective actions that the Bank will take to address the finding that [REDACTED] violated the Equal Credit Opportunity Act and its implementing Regulation B by engaging in a pattern and practice of discrimination on the basis of race and national origin.¹ More specifically, we found that, on average, [REDACTED] charged African American, Hispanic and Asian-Pacific Islanders borrowers higher dealer markups for its indirect auto loans than non-Hispanic white borrowers.

Pursuant to the MOU, on August 21, 2014, the Bureau, through its Northeast Region Director, provided its non-objection to [REDACTED]'s Compliance Plan. Among other things, the Compliance Plan describes how [REDACTED] will monitor markup disparities on a monthly forward-looking basis, and how it will reimburse borrowers in the event that the monthly analysis reveals markup disparities of 10 basis points (bps) or more between non-Hispanic white borrowers and Black/Hispanic/Asian borrowers. The specifics on how to calculate reimbursement amount are described in a one-page document titled *Multiplier Example*.

II. Issue

Since the Regional Director provided non-objections to the Compliance Plan,² we have had several calls with [REDACTED] regarding its progress in implementing the Compliance Plan. Because [REDACTED] initially focused on providing backward-looking remediation (covering the period 2010 – 2013), [REDACTED] did not discuss forward-looking remediation (covering 2014 and onward) until May 27, 2015. During that call, and also through subsequent follow-ups, we concluded that [REDACTED] is planning to implement a forward-looking remediation methodology that is different from our understanding of what was proposed in the Compliance Plan as described in *Multiplier Example*.³

¹ Additional details can be found in the Supervisory Letter dated February 14, 2014.

² The last non-objection was given to [REDACTED] in October 2014.

³ [REDACTED] stated that it did not modify the agreed-to forward-looking remediation methodology; it claimed that what they plan to do is consistent with what they had thought they agreed to.

III. Summary of the Methodologies

For forward-looking remediation, ██████ proposed the following methodology: If the overall disparity for a particular group is 10 bps or more for a particular month, ██████ will provide an interest-rate reduction to those borrowers whose likelihood of being in that group exceeds a certain threshold (e.g., 80%) and who paid above the Non-Hispanic White (NHW) average markup. The interest-rate reduction will be “scaled up” by a multiplier to account for the fact that not all affected borrowers will receive remuneration—only those above the threshold who also paid more than the NHW average. The following example illustrates the methodology:

- Assume the NHW average markup is 100 bps and the Hispanic/NHW disparity is 25 bps. This means Hispanics on average paid $25/100 = 25\%$ more in markup than NHW.
- Assume the total number of Hispanics is 2 times the number of Hispanics who will be remunerated (since remuneration is limited to those over the 80% threshold who paid > 100 bps). The methodology applies a multiplier of 2 to scale-up the compensation to Hispanics who do receive remuneration: These borrowers will have their markups reduced by $(2)*(25\%) = 50\%$.

It is noteworthy that this methodology, while guaranteed to reduce markup disparities, does not guarantee to make the post-remediation disparities disappear completely; it is possible for the post-remediation disparities to be greater than 10 bps, between 0 and 10 bps, or less than 0 bps. ██████ is still required to conduct annual fair lending assessments under the Plan, and if the annual disparity, after accounting for the monthly remediation, is still 10 bps or greater, ██████ is required to remediate further.

██████ modified the agreed-to methodology by adjusting the multiplier in the event that the post-remediation disparities fall outside of the 0 to 10 bps range; this adjustment is not mentioned in the *Multiplier Example*. For 2014 loans, following the methodology under the Compliance Plan, the post-remediation disparities in the Prime channel would be negative, so ██████ reduced the multiplier applicable to that channel by 20% to keep post-remediation disparities above zero.⁴ This adjustment resulted in less compensation to victims.

IV. Fair Lending Office’s Recommendation

Fair Lending recommends resolving this issue in the following way:

- Until ██████ actually starts the monthly monitoring and remediation process, we would require ██████ to implement the forward-looking remediation methodology that is consistent with our understanding of the Compliance Plan. This means that for the entire year of 2014 and at least the first half of 2015, ██████ should not apply any adjustments to the multipliers.
- Once ██████ starts the monthly remediation process (presumably for loans originated in July 2015 and later), it has the option of implementing the revised methodology as explained in its June 1, 2015 deck, except that when ██████ discounts the multipliers to address post-remediation disparities that are less than zero, it should bring the post-remediation disparities to 0 bps instead of between 0 – 10 bps.

⁴ No adjustment was made to the multiplier for the other indirect auto loan channels because their post-remediation disparities were between 0 and 10 bps after applying the Compliance Plan methodology.

As indicated in the second bullet, Fair Lending is agreeable to modifying the forward-looking remediation methodology in a way that is similar to, but not exactly the same as, [REDACTED]'s modified methodology. The primary reason for allowing this change is that in other fair lending indirect auto examinations, we have agreed to forward-looking remediation methodologies similar to what is proposed in the second bullet—that is, managing disparities to 0 bps as part of periodic, short-term monitoring of outcomes. Therefore, for the sake of consistency and fairness, and having no reason to treat [REDACTED] differently, we recommend allowing the modification.

On the other hand, as indicated in the first bullet, we recommend against allowing [REDACTED] to make this change until it starts monitoring and providing remediation on a monthly basis. There are two reasons for our recommendation. First, [REDACTED] should not have changed the methodology without first getting our non-objection; therefore, we recommend not allowing the modified method to apply prior to the point at which we were informed about it. Second, we view the modified methodology to be acceptable only when it is applied on a forward-looking and ongoing basis, analyzing data periodically for one short period (i.e., monthly or quarterly) at a time, with the goal of avoiding disparities when outcomes are assessed over a longer period more typical of fair lending assessments (i.e., annually). While 2014 and the first half of 2015 are technically part of the “forward-looking” period under the MOU and the Compliance Plan, they are so categorized only because it took some time to finalize the Compliance Plan. In deciding on remediation for disparities over a time period of 12-18 months, we do not think it is appropriate to apply a methodology that is acceptable only in the context of more frequent and shorter-term monitoring and remediation.