

April 5, 2016

The Honorable Richard Shelby, Chairman  
Banking, Housing, and Urban Affairs Committee  
United States Senate  
534 Dirksen Senate Office Building  
Washington, DC 20510

The Honorable Sherrod Brown, Ranking Member  
Banking, Housing, and Urban Affairs Committee  
United States Senate  
713 Hart Senate Office Bldg.  
Washington, DC 20510

Dear Chairman Shelby and Ranking Member Brown:

In November 2014, AFSA released a comprehensive study of the indirect vehicle finance model. The study, Fair Lending: Implications for the Indirect Auto Finance Market, conducted by Charles River Associates (CRA), found that the disparity alleged by the Consumer Financial Protection Bureau (CFPB) between the amount of dealer reserve charged to minorities and non-minorities is not supported by data. Below are the key findings of the study, which we are sending to you in advance of the April 7 hearing, The Consumer Financial Protection Bureau's Semi-Annual Report to Congress.

The research illustrates the complexities of indirect automobile financing and evaluates current regulatory fair lending practices. Utilizing a wide array of industry data and a database consisting of approximately 8.2 million new and used vehicle contracts originated during 2012 and 2013, the study measured disparities in dealer reserve using the CFPB's methodology to proxy for race/ethnicity (BISG).

The study concludes there is little evidence that dealers systematically charge different dealer reserves on a prohibited basis. Rather, variations in dealer reserves across contracts can be largely explained by objective factors other than race and ethnicity. In addition, the use of race and ethnicity proxies creates significant measurement errors, overestimates minority population counts, and results in overstated disparities. These overestimates and overstatements can contribute to inflated estimates of alleged consumer harm.

The key findings of the CRA study are:

- 1. When appropriately considering the relevant market complexities and adjusting for proxy bias and error, the observed variations in dealer reserve are largely explained.** When analyzing dealer reserve, the CFPB did not control for relevant factors (e.g. credit worthiness, the differences in new versus used vehicles, etc.). The CFPB's consistent position is that these controls are inappropriate, notwithstanding significant evidence that they have a causal relationship on dealer reserve.
- 2. The Bayesian Improved Surname Geocoding (BISG) proxy methodology is conceptually flawed in its application and subject to significant bias and estimation error.** The CFPB acknowledges that the BISG proxy methodology overestimated minorities in the mortgage market. However, the CFPB asserts that it does not know if the BISG proxy

methodology overestimates minorities in auto loans. Despite the CFPB's assertion, there is no strong evidence that the BISG proxy methodology works any better when applied to the auto lending market.

- 3. The use of biased race and ethnicity proxies creates significant measurement error, which likely results in overstated disparities.** Internally, the CFPB tested a number of CRA's suggested methods for reducing the measurement error. In test after test, the CFPB found substantively reduced disparities by as much as 50%, particularly with respect to African American and Hispanic borrowers. Nonetheless, the CFPB continues to use its original method, without adjustment.
- 4. The Department of Justice (DOJ) recognizes that dealer reserves depend on objective, observable business factors. Failure to consider legitimate business factors for observed disparities increases the potential for reaching erroneous conclusions.** The key business factor is the presence of a competitive offer. In settlements almost a decade ago, the DOJ recognized the importance of this factor in understanding differences in dealer reserve. More recently, the CFPB has acknowledged this factor in consent orders by allowing financial institutions to adjust rates to reflect competitive offers. Furthermore, the Center For Responsible Lending (CRL) concurs. In a November 2015 policy brief, CRL stated, "[Customers] who did not pay a markup or paid a small amount of markup likely had a competing credit offer in hand." CRL correctly points out that the competitive offer, rather than race/ethnicity, is what results in customers receiving zero or low dealer reserve contracts. Yet despite this, the CFPB continues to use its original method without adjustments – and thereby attributes to race/ethnicity, disparities that reflect the effect of competitive offers.
- 5. Aggregating contracts originated by individual dealers to the portfolio level may create the appearance of differential pricing on a prohibited basis when none exists.** When the CFPB tested the effect of dealer aggregation (another robustness test), they found that aggregation alone explained about one-third of the observed disparities measured in the CFPB's method. Yet still the CFPB continues to use its original method, without adjustment. Again, this results in the CFPB attributing to race/ethnicity disparities that are reflected in aggregation.

We hope you keep in mind the CRA study in your exchange with CFPB Director Richard Cordray on April 7. Please contact me at 202-466-8616 or [bhimpler@afsamail.org](mailto:bhimpler@afsamail.org) with any questions.

Sincerely,



Bill Himpler  
Executive Vice President  
American Financial Services Association