Protecting Credit Since 1916
American Financial Services Association

April 26, 2019

The Honorable Al Green
Chairman
Subcommittee on Oversight and Investigations
Committee on Financial Services
U.S. House of Representatives
Washington, DC 20515

The Honorable Andy Barr
Ranking Member
Subcommittee on Oversight and Investigations
Committee on Financial Services
U.S. House of Representatives
Washington, DC 20515

Dear Chairman Green and Ranking Member Barr:

On behalf of the American Financial Services Association (AFSA)[1], I am writing today in advance of your hearing, "Examining Discrimination in the Automobile Loan and Insurance Industries." The purchase of a vehicle is one of the most important financial decisions an individual can make, and auto financing is a crucial aspect of that decision.

AFSA and its members abhor discrimination in all forms and are committed to treating all individuals fairly and equitably in the financing and servicing processes. As you know, vehicle finance companies are prohibited by the Equal Credit Opportunity Act from collecting race or ethnicity information from credit applicants. Because vehicle finance companies do not have race or ethnicity information, they do not discriminate against consumers directly, practicing disparate treatment on customers. Therefore, in the absence of disparate treatment, regulators then look for disparate impact.

The legal theory of disparate impact holds that practices that are neutral on their face may be considered discriminatory if they have a disproportionate "adverse effect" on persons in a protected class. However, there is a difference between disparate treatment targeting members of protected classes versus facially neutral treatment that may inadvertently result in disparate impact. Regulators cannot use disparate impact to enforce against indirect auto lenders who never see a customer or have any knowledge of the customer's race.

In response to allegations of disparate impact in the vehicle finance industry, AFSA commissioned a comprehensive study. Released in late 2014, the study, <u>Fair Lending: Implications for the Indirect Auto Finance Market</u>, conducted by Charles River Associates (CRA), found no data to support the alleged discrepancy in dealer reserve charged to minorities and non-minorities.[2]

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[1] Founded in 1916, AFSA is the national trade association for the consumer credit industry, protecting access to credit and consumer choice. AFSA members provide consumers with many kinds of credit, including traditional installment loans, mortgages, direct and indirect vehicle financing, payment cards, and retail sales finance.

[2] Baines, Arthur P. and Marsha J. Courchane. *Fair Lending: Implications for the Indirect Auto Finance Market.* 2014.

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The CRA research illustrates the complexities of indirect automobile financing and evaluates current regulatory fair lending practices. Using a wide array of industry data and a database consisting of approximately 8.2 million new and used vehicle contracts, the study measured disparities in dealer reserve using the CFPB's methodology to proxy for race/ethnicity (the Bayesian Improved Surname Geocoding (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.** Factors such as credit worthiness, differences in new/used vehicles, and other factors impact 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 BISG proxy methodology overestimated minorities in the mortgage market, but it has not been determined that BISG methodology overestimated minorities in auto loans.

3. **The use of biased race and ethnicity proxies creates significant measurement error, which likely results in overstated disparities.**

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 over a decade ago, the DOJ recognized the importance of this factor in understanding differences in dealer reserve. 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.

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.**

In conclusion, we appreciate your allowing us to explain the CRA study and to comment on the hearing. Preserving competition in auto finance is in the best interest of consumers, as it drives down prices and increases financing options. Auto lenders want to eliminate discrimination, not only because the law so requires, but in efforts to maintain trust and relationships with their customers. Auto industry participants support financial education for consumers to help ensure they are prepared to make informed, intelligent choices on credit-related decisions. AFSA members are dedicated to protecting access to credit and consumer choices and transparency in the lending process, and we appreciate the opportunity to comment today.

Should you need additional information or have any questions, please feel free to contact me at bhimpler@afsamail.org or (202) 466-8616. Thank you very much for the opportunity to comment.

Sincerely,

Bill Himpler
President & CEO
American Financial Services Association