

**EXAMINING DISCRIMINATION
IN THE AUTOMOBILE LOAN
AND INSURANCE INDUSTRIES**

HEARING
BEFORE THE
SUBCOMMITTEE ON OVERSIGHT
AND INVESTIGATIONS
OF THE
COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES
ONE HUNDRED SIXTEENTH CONGRESS
FIRST SESSION

MAY 1, 2019

Printed for the use of the Committee on Financial Services

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CONTENTS

	Page
Hearing held on:	
May 1, 2019	1
Appendix:	
May 1, 2019	41

WITNESSES

WEDNESDAY, MAY 1, 2019

Clarke, Kristen, President and Executive Director, Lawyers' Committee for Civil Rights Under Law	9
Cross, Rachel J., Policy Analyst, Frontier Group	7
Lynch, James, Chief Actuary, and Senior Vice President, Research and Education, Insurance Information Institute	12
Rivera, Joshua, Data and Policy Advisor, Poverty Solutions at the University of Michigan	11
Van Alst, John W., Attorney, National Consumer Law Center (NCLC), and Director, Working Cars for Working Families, an NCLC Project	5

APPENDIX

Prepared statements:	
Clarke, Kristen,	42
Cross, Rachel J.	51
Lynch, James,	57
Rivera, Joshua	63
Van Alst, John,	74

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

Green, Hon. Al:	
Written statement of the National Association of Insurance Commissioners	165
Written statement of the National Association of Mutual Insurance Companies	167
Written statement of UnidosUS	173
Barr, Hon. Andy:	
Report entitled, "Fair Lending: Implications for the Indirect Auto Finance Market," prepared by Charles River Associates for the American Financial Services Association, dated November 19, 2014	180
Report of the Insurance Research Council entitled, "Auto Insurance Affordability: Cost Drivers in Michigan," dated April 2019	323
Joint insurance trades letter, dated April 29, 2019	342
Written statement of the National Association of Mutual Insurance Companies	343
Written statement of the National Automobile Dealers Association	349
Beatty, Hon. Joyce:	
Written responses to questions for the record from Joshua Rivera	359
Steil, Hon. Bryan:	
Written statement of the American Property Casualty Insurance Association	362
Zeldin, Hon. Lee:	
Written statement of the National Automobile Dealers Association	364

EXAMINING DISCRIMINATION IN THE AUTOMOBILE LOAN AND INSURANCE INDUSTRIES

Wednesday, May 1, 2019

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON OVERSIGHT
AND INVESTIGATIONS,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10:05 a.m., in room 2128, Rayburn House Office Building, Hon. Al Green [chairman of the subcommittee] presiding.

Members present: Representatives Green, Beatty, Tlaib, Garcia of Texas; Barr, Posey, Zeldin, Loudermilk, Davidson, Rose, and Steil.

Ex officio present: Representatives Waters and McHenry.

Also present: Representative Budd.

Chairman GREEN. Good morning, everyone.

The Oversight and Investigations Subcommittee will come to order.

The title of today's subcommittee hearing is, "Examining Discrimination in the Automobile Loan and Insurance Industries."

Without objection, the Chair is authorized to declare a recess of the subcommittee at any time. Also, without objection, members of the full Financial Services Committee who are not members of the subcommittee may participate in today's hearing for the purposes of making an opening statement and questioning the witnesses. Mr. Budd appears to be here; I ask unanimous consent that he be allowed to participate. Without objection, it is so ordered.

Today's hearing, as I indicated, is styled, "Examining Discrimination in the Automobile Loan and Insurance Industries", and it is long overdue.

I now recognize myself for 5 minutes to give an opening statement.

This hearing is long overdue. The empirical evidence has shown that non-white vehicle buyers who were more qualified than white buyers received costlier loans 62.5 percent of the time, according to a 2018 study by the National Fair Housing Alliance. African-American males pay more for dealer markups than white males, and these dealer markups, which are unrelated to credit risk, allow for predatory pricing and invidious discrimination.

A 2015 Consumer Federation of America (CFA) study found that a driver living in a predominantly African-American neighborhood

can expect to pay insurance premiums that are on average 70 percent more than similarly situated drivers in neighborhoods where African Americans are in the minority.

A 2017 CFA study found that most auto insurers charge middle-aged women higher rates than men. In Houston Texas, women with perfect driving records pay on average \$75 more than men with the same record, at the same address, with the same vehicle.

At \$1.26 trillion, auto loans are the third largest household debt category, after mortgage loans and student loans. What once was considered a luxury is now a necessity as evidenced by the fact that nearly every American household has at least one car.

Let me summarize by saying this: I said that this hearing was long overdue and it is because the empirical evidence that I have cited—which is but a scintilla of what is available—seems to overwhelmingly indicate that certain persons pay more than others for the same product, and these bits of evidence have been called to our attention by way of advocacy groups and persons who are intellectuals, scholarly persons, and they use a method called Testing. And using this Testing, this empirical evidence seems to be valid; it seems to indicate that there are problems that we have to address.

The purpose of this hearing is not only to expose the empirical evidence but also to address or conclude in some way that there are means by which we can address the problems that will be called to our attention.

I am grateful that we have witnesses here who can give us the additional information that we will need to draw our conclusions, but I also want to close with this: I think that we owe it to ourselves as a country to make sure every person is treated fairly when making an automobile purchase. We have the ability and the power and the authority in Congress to do this. The question is, do we have the will to make a difference for people who are in need of a car, who are probably not making as much money as Members of Congress but who dearly need the opportunity to have this necessity so that they can get to and from their jobs. And my hope is that we will be able to achieve that fairness through this hearing.

With this said, I am going to reserve the balance of my time for Chairwoman Waters.

I will now yield to the ranking member of the subcommittee, Mr. Barr.

Mr. BARR. Thank you, Chairman Green.

And I want to start by acknowledging our Subcommittee Chairman, Al Green, for convening this hearing. Thank you, Mr. Chairman, especially for all your efforts over the course of your congressional career and working to combat discrimination, race discrimination which is to be commended, and I am pleased to participate in this hearing. I welcome all of our witnesses; all of your work and efforts are a great value to our committee and we thank you for being here today.

Obviously, race discrimination is abhorrent and it should not be tolerated in auto lending or the insurance industries or any industry. There is anecdotal evidence of auto lenders charging different rates based on a borrower's race so we are here to understand

today how the industry has changed, how it prices risk without discriminating on the basis of race, and what needs to be done to make sure that everyone is treated fairly regardless of race.

This committee has spent considerable time examining discrimination in auto lending and we take this issue very seriously. The committee has investigated and released several reports on this matter in the past and our work is ongoing.

Studies purporting to show widespread discrimination in auto lending have routinely proven flawed, for example a 2013 report by the Consumer Financial Protection Bureau (CFPB) contended that dealer-assisted auto financing has a “disparate impact on the price of credit for consumers in protected classes.” As it turned out, the CFPB’s methodology for counting African Americans was off by 41 percent, among many other problems.

The committee’s investigation of the matter found that the CFPB knew its methods were deeply flawed and prone to significant error, according to internal documents, but the CFPB released its study anyway.

To be clear, racial discrimination in auto lending is illegal, as it should be. We must ensure that the industry does not move backwards and we need to base that work on accurate data and reliable findings. States continue to be the most effective regulators of the auto lending industry as has been the case for almost a century. This was certainly true in 2010 when the Dodd-Frank Act was enacted. Section 1029 of the Dodd-Frank Act specifically excluded auto dealers from the CFPB’s jurisdiction; it was obvious then as it is now that States were best positioned to ensure that consumers are protected.

We will also examine the auto insurance industry. The United States has the largest and most competitive market for auto insurance in the world. Like auto lending, the auto insurance industry is regulated at the State level. In fact, these are two of the most heavily regulated industries in the entire financial services portfolio. The price for auto insurance varies throughout the country depending on a litany of variables, and the competitive nature of this industry has led to more affordable prices for consumers.

As with so many other things, the key to lower prices is free markets. We need look no further than Illinois to understand why; in Illinois, an inadvertent lapse in regulations allowed a flood of insurance companies to enter the market, that competition drove down prices for consumers, and the Illinois Legislature chose not to enact new rate regulations.

It is not just competition that affects the price of insurance, State laws greatly affect prices as well. In 2019, Michigan was ranked as the State with the highest insurance premiums. The high prices in Michigan reflect decisions by the State Legislature and the insurance commissioner; Michigan’s No-Fault Insurance Law provides for potentially unlimited lifetime medical assistance for people involved in accidents and this law leads to abuse of the legal system and fraud.

Insurance experts have drawn a direct correlation between the No-Fault Insurance Laws and Michigan’s high rates.

Unlawful discrimination in setting insurance rates is inexcusable and it is already prohibited at the Federal and State level. In addi-

tion, industry standards forbid the use of certain factors such as race when determining rates. Those in the industry have worked to create a system where the insurance credit-ratings are purposely blind to the race of an applicant.

I look forward to working with the chairman to ensure that discrimination does not occur in auto lending or insurance, but I also do not want to eliminate risk-based pricing in a way that could increase premiums for most drivers.

Thank you. And I yield back.

Chairman GREEN. Thank you.

And the Chair will now yield 1 minute to the Chair of the full Financial Services Committee, the Honorable Maxine Waters.

Chairwoman WATERS. Thank you very much, Mr. Chairman.

Buying a car is a significant purchase for many Americans and should be a fair and transparent transaction, free of discrimination. Unfortunately, this is not the case for persons of color.

The National Fair Housing Alliance, in a test of auto lending discrimination, found that nearly two-thirds of minority loan applicants received higher-cost financing options from automobile dealers than less-qualified white applicants.

Last Congress, Republicans impeded enforcement of fair lending laws, making discrimination potentially worse. They used the Congressional Review Act to rescind the Consumer Financial Protection Bureau's much-needed guidance to indirect auto lenders on how to comply with the Equal Credit Opportunity Act.

Discrimination also exists in the auto insurance industry. For example, the Consumer Federation of America found that auto insurers charged women and persons living in predominantly African-American communities disproportionately higher premiums. These types of practices warrant congressional scrutiny, analysis, and ultimately legislation.

With that, Mr. Chairman, I yield back the balance of my time.

Chairman GREEN. The gentlelady yields back.

The Chair now recognizes the ranking member of the Full Committee, the Honorable Mr. McHenry.

Mr. McHENRY. Thank you, Chairman Green. And thank you for your leadership, especially on this topic.

And thank you to Ranking Member Barr, as well, for his leadership.

So let me be clear, there is no place for discrimination, period. The idea that lenders or insurers would charge a different rate based on skin color, ethnicity, or gender is contrary to everything that we stand for as a society.

To have this discussion, we must have the most accurate statistics available. As Congressman Barr outlined, the CFPB used an algorithm that attempted to identify the race of borrowers based simply on their name and address. I don't have to look any further than my own community to see the failure of that practice, seeing as there are two families named McHenry in my hometown, and our race and ethnicity is different. So a name does not do justice nor does a zip code simply do justice to an understanding of race.

As it turns out, the CFPB later acknowledged that algorithm had a 20 percent error rate. And then an independent analysis of it said that it could be as high as 40 percent. Both the lending and insur-

ance industries, which are the focus of today's hearing, are regulated at the State level. So I wanted to understand if there any limitations on the States taking appropriate action to make sure that this does not happen.

So with that, thank you, Mr. Green.

Chairman GREEN. The gentleman yields back.

We now welcome our witnesses: Mr. John Van Alst, an attorney at the National Consumer Law Center, and the director of Working Cars for Working Families, an NCLC project; Ms. Rachel J. Cross, a policy analyst at Frontier Group; Ms. Kristen Clarke, president and executive director of Lawyers' Committee for Civil Rights Under Law; and Mr. Joshua Rivera—Ms. Tlaib, a member of this committee, is from Michigan, so she will say more about Mr. Rivera.

Ms. TLAIB. Oh, are you recognizing me, Mr. Chairman?

Chairman GREEN. Yes.

Ms. TLAIB. Thank you so much.

I just want to thank so much Mr. Rivera, who co-authored, "Auto Insurance and Economic Mobility in Michigan," but I also want my colleagues to know our emphasis and advocacy around non-driving factors, which go beyond just race-based kind of discrimination.

I am so thankful for the leadership of Ranking Member Barr, Chairman Green, and our incredible Chairwoman Maxine Waters for making this a very important critical issue to talk about the fact that we are increasingly using non-driving factors, people who become widowed, retired, and so forth are being considered as factors against car rates.

Thank you so much, Mr. Chairman.

Chairman GREEN. Thank you for your remarks.

Moving on, the final witness will be Mr. James Lynch, the senior vice president of research and education at the Insurance Information Institute.

I would like to welcome and thank you all for being here. The witnesses will each be recognized for 5 minutes to give an oral presentation of their testimony. And without objection, the witnesses' written statements will be made a part of the record. Once the witnesses have finished presenting their testimony, each member of the subcommittee will have 5 minutes within which to ask questions.

On your table, and this is directed to the witnesses, you will see three lights: the green light means that you may go; the yellow light is the indicator that you have 1 minute left and you are running out of time; and the red light of course means that you are out of time. The microphones are very sensitive so please make sure you speak directly into them.

With that, Mr. Van Alst, you are now recognized for 5 minutes.

STATEMENT OF JOHN W. VAN ALST, ATTORNEY, NATIONAL CONSUMER LAW CENTER (NCLC), AND DIRECTOR, WORKING CARS FOR WORKING FAMILIES, AN NCLC PROJECT

Mr. VAN ALST. Chairman Green, Ranking Member Barr, and distinguished members of the subcommittee, thank you for inviting me here today to discuss discrimination in cars.

I am an attorney with the National Consumer Law Center where I work with Legal Services attorneys, government attorneys, and private attorneys across the country, all of whom help low-income families with issues with cars and car finance.

I also direct NCLC's Working Cars for Working Families project which works to ensure that families get a fair deal when buying and financing a car, and that the lack of a car does not stand in the way of a family's ability to become economically successful.

A car can provide physical mobility but also economic mobility, allowing families to get to work, live in more affordable housing, and take advantage of educational opportunities.

While cars can be a tool to help escape poverty, they are very expensive. In 2018, the average used car price exceeded \$20,000, and for a consumer with subprime credit, monthly payments were over \$400 and the average interest rate was over 16 percent. But for some consumers, buying, financing, and using a car can be even more expensive because of their race and ethnicity. Some are charged hundreds and even thousands of dollars more in interest rate markups. These are discretionary increases that the dealer makes to the interest rates which have already been objectively set based on the consumer's credit risk.

In 12 cases that the NCLC co-counseled between 1998 and 2007, we coded millions of transactions for race based upon driver's license data. Within each credit tier, dealers marked up African Americans' interest rates almost twice as often as whites. And when African Americans rates were marked up, the markups were on average almost double those charged to whites.

And the disparities don't stop at financing. Some consumers are more likely to be pressured to buy add-on products such as service contracts, and GAP. They are then charged more for these same products they are pressured to buy.

In 2017, we examined a data set of millions of add-on transactions and found that Hispanic car-buyers were charged higher markups for add-ons at both the State and dealer level.

These disparities make cars more expensive for some races and ethnic groups. They unnecessarily increase the cost of a car and increase the chance of default. In some cases, these higher costs keep families from getting a car at all. This contributes to disparities we see across the country in terms of access to cars.

For families at or below the Federal Poverty Guidelines, 13 percent of white households lack access to a car compared to 31 percent of African-American households and 20 percent of Hispanic households.

Many of the disparities we will discuss here today are only possible because the market for cars and especially car-financing used cars is opaque and inconsistent.

Dealers have tremendous discretion to charge consumers different prices and the price setting takes place in a back room where dealers have to decide quickly how far they can push the consumer, and no one knows what anyone else pays for the car, the financing or the add-ons.

A more consistent and transparent marketplace would not only benefit consumers of color, but everyone including dealers and fi-

nance entities that want to compete fairly and openly on price and quality on a level playing field.

Towards this goal, we must ban dealer interest-rate markups, amend the Equal Credit Opportunity Act to enable data collection, prohibit discrimination in the pricing of goods and services in addition to discrimination in financing, increase enforcement of the Equal Credit Opportunity Act; and increase enforcement of general protections against general abuses in the sale or financing of cars.

Given the evidence we have seen in discrimination in financing and other parts of the sale transaction, it is likely that many other abuses from yo-yo sales, to failure to pay off existing liens, are more likely to affect people of color.

I commend the subcommittee for holding today's hearing on such an important topic and we stand ready to work with this subcommittee and other interested parties in bringing consistency, transparency, and fairness to the auto market. Thank you.

[The prepared statement of Mr. Van Alst can be found on page 74 of the appendix.]

Chairman GREEN. Thank you. We will next hear from Rachel J. Cross. You have 5 minutes.

**STATEMENT OF RACHEL J. CROSS, POLICY ANALYST,
FRONTIER GROUP**

Ms. CROSS. Thank you for the opportunity to appear before you today to discuss the state of U.S. auto lending. I am a policy analyst with Frontier Group and I am also testifying on behalf of the U.S. PIRG, the Public Interest Research Group with whom we co-authored our recent report, "Driving into Debt," which examines how auto lending has changed since the Great Recession and what this means for consumers.

In much of the country, owning a car is a virtual necessity. It is how many of us get to work, to school, to the grocery store and doctor; a car, in short, is the price of admission to living a full and productive life, but owning a car is also expensive and has driven millions of households to take on debt. Right now, Americans owe more for our cars than we ever have before; outstanding auto debt is over \$1.2 trillion, and since the end of 2009 that amount has increased by over 50 percent.

But it is not just that the overall auto debt has reached historic levels; the number of Americans who owe for their cars is also the highest in U.S. history and consumers are at risk, delinquencies are rising, the percentage of auto debt that is seriously delinquent, meaning 90 days late at least or more, is the highest it has been since 2012 and it is still rising. More than 7 million Americans have missed at least 3 monthly car payments.

These numbers are concerning on their own, but what makes them deeply troubling is that they are happening in a strong U.S. economy, something important has been happening in the auto credit market. The lending practices since the recession that have boosted auto sales have come at a cost, the increased risk of financial instability for millions of American households.

There are a few key steps that have gotten us to the point that we are at now. In the aftermath of the 2008 financial crash, investors and lenders alike noticed that auto debt performed relatively

well compared to other securities during the recession and this sparked more interest in bringing more borrowers into the auto credit market and lenders of all types did so.

First, they loosened standards for prospective borrowers. We found in our report that auto debt has risen across all income levels but it has risen the fastest among those with the lowest incomes. Since 2009, borrowing by residents of low-income neighborhoods has increased nearly twice as quickly as borrowing by residents of the highest-income neighborhoods. Lending in the subprime market followed a similar trajectory.

Lenders have used other tools to bring borrowers in the marketplace, including the lengthening of loan terms. Extending a loan term brings down that monthly payment, which is an important measure for determining affordability particularly for lower-income consumers, but it also means that the consumer will pay more over the life of the loan due to interest payments, and will spend more time underwater or owing more for their car, and that is even worse.

Consumers with a 6-year loan are twice as likely to default as others with a 5-year loan, and those borrowers are also more likely to have a poor credit history, lower income, and to pay higher interest rates than other borrowers.

In 2017, 42 percent of all loans generated had terms of 6 years or more. This period also saw the rise of more outright abusive and predatory tactics in one specific part of the auto credit market: dealer financing.

A direct loan that a consumer gets directly from a financial institution like a bank or credit union is, generally speaking, a safer bet for consumers. Indirect lending, however, is when the consumer finances through a dealership, where the dealer is a creditor, assigns the loan to another financial institution, and often has the consumer sign a retail installment sales contract. Dealer-arranged financing has weaker regulations and oversight than direct loans, enabling a number of abusive and predatory tactics.

One area of abuse is excessive interest rates. When a dealer sells its financed contract to another lender, they are able to mark up that interest rate and pocket the difference as profit.

Having consumers sign a retail installment sales contract also allows the dealer to charge an interest rate that can sometimes exceed State usury limits. In one example, a package of securities that Santander Bank was selling to investors was found to have 57 percent of all loans generated in the State of New York to be carrying interest rates that are so high, they would have been illegal if they had been from direct loans between a consumer and a bank. But because they were dealer-financed and indirect loans, it was legal.

There has also been evidence of lenders failing to verify the income of borrowers, and even car salesmen inflating the consumer's income to ensure that they qualify for financing even if they ultimately cannot afford it. In key respects, auto lending in the last decade has been a Groundhog-Day repeat of the exact same practices that brought us to the 2008 market crash.

Dealer-arranged financing has also enabled discriminatory pricing. Since its creation, the Consumer Financial Protection Bureau

has investigated a number of large captive finance groups that provide indirect financing for charging borrowers of color higher interest rates than similarly situated white borrowers. These include some of the largest indirect lending firms in the nation like Toyota Motor Credit. These policies led to many African-American borrowers paying \$200 more on average for financing.

The CFPB investigations have repeatedly found that lenders giving dealers the ability and incentive to mark up interest rates enables this kind of discrimination. However, since the congressional repeal of the CFPB's Indirect Auto Guidance and changes in leadership, we have seen a lack of will to continue protecting consumers as they deserve.

These are only a few examples of the way that dealer financing threatens the financial well-being of Americans. The entire list of threats that consumers, in particular the most vulnerable amongst us face, is appalling, and that so little action has been taken to stop these predatory behaviors is even more appalling.

Thank you.

[The prepared statement of Ms. Cross can be found on page 51 of the appendix.]

Chairman GREEN. We will now hear from Kristen Clarke. You are recognized for 5 minutes.

STATEMENT OF KRISTEN CLARKE, PRESIDENT AND EXECUTIVE DIRECTOR, LAWYERS' COMMITTEE FOR CIVIL RIGHTS UNDER LAW

Ms. CLARKE. Chairman Green, Ranking Member Barr, and members of the subcommittee, my name is Kristen Clarke and I am president and executive director of the Lawyers' Committee for Civil Rights Under Law. Thank you for the opportunity to testify today about the discrimination in the automobile loan industry.

The Lawyers' Committee is a national non-partisan civil rights organization created at the request of President John F. Kennedy to activate the private bar in the fight against discrimination, and for over 55 years we have been on the frontlines of our nation's fight for justice in the areas of economic justice, voting rights, fair housing, criminal justice, education, hate crimes, and more.

We know that eliminating lending discrimination, root and branch, particularly across the auto industry must stand as a core civil rights priority today.

Discriminatory auto lending poses grave financial danger to African-American, Latino, and other vulnerable consumers; increasingly, lenders are taking advantage of a highly unregulated and unmonitored market to promote discriminatory and predatory practices. We thank this committee for sounding an alarm about this and undertaking careful fact-finding to identify a remedial response.

All Americans need reliable transportation to access jobs and schools, as has been noted, and we know that communities of color that are deprived of economic investment often lack effective public transportation, those who can't rely on public transportation often need an affordable loan to finance the purchase of a car and to help them build good credit.

As the third largest source of outstanding household debt after mortgages and student loans, car loans and their impact on communities of color warrant greater scrutiny.

There is a stark racial wealth divide in our country today. A typical white family has \$140,000 in wealth, while a typical African-American family has just over \$3,400. Abusive, predatory automobile lending and lack of access to equitable financial services contribute to and exacerbate this racial wealth gap.

Widespread racial discrimination in the market is not new and has been well documented over the past 30 years. African Americans and other consumers of color face discrimination in various ways when purchasing and financing a car. They are often charged higher prices, higher interest rates, and more expensive insurance rates on the basis of their race or ethnicity, and they are also targeted for predatory sales and repossession schemes.

Racial bias also seeps into the industry by way of discretionary dealer markups and often indirect auto lenders fail to have controls in place to prevent discretionary markup-pricing disparities resulting from car dealers' racial bias, resulting in people of color being burdened with more expensive loans than white consumers.

While much lending discrimination can be identified through statistics, there is also evidence of intentional discrimination throughout the industry. In 2014 the Justice Department secured settlements with Auto Fare and Southeastern Auto Corp in North Carolina for engaging in reverse redlining. The dealerships targeted black consumers with unfair and predatory credit practices and the dealership operator expressed his view that African-American customers have fewer credit options, making them more likely to accept predatory contracts.

A recent 2018 study by the National Fair Housing Alliance used matched-pair testing in Virginia that showed that almost 63 percent of the time, borrowers of color received costlier loans even though they were more qualified than their white counterparts.

Under this Administration, the Justice Department has retreated from Fair Lending enforcement against dealers, not surprisingly after the rollback of the critical 2013 CFPB Guidance we saw several lenders who had previously implemented flat-fee models, revert back to discretionary dealer-rate programs.

What must be done? We ask Congress to enact robust legislation to increase protections for borrowers of color by prohibiting or significantly limiting discretionary dealer markups. We need more oversight over the Justice Department and the CFPB to understand why their enforcement activity has come to a grinding halt. And finally we need more transparency and data collection to help us get to better understand that the extent of discrimination across the auto lending industry.

Thank you.

[The prepared statement of Ms. Clarke can be found on page 42 of the appendix.]

Chairman GREEN. Thank you.

Mr. Joshua Rivera, you are now recognized for 5 minutes.

**STATEMENT OF JOSHUA RIVERA, DATA AND POLICY ADVISOR,
POVERTY SOLUTIONS AT THE UNIVERSITY OF MICHIGAN**

Mr. RIVERA. Chairman Green, Ranking Member Barr, and distinguished members of the subcommittee, thank you for inviting me to testify today. I appreciate the opportunity to discuss auto insurance and affordability and the disproportionate impact of certain rate-setting practices on low-income and minority drivers.

Our team at Poverty Solutions first got the idea to research auto insurance directly from Detroit residents; to our surprise, in conversation after conversation with local stakeholders, the issue of auto insurance just kept coming up as a major poverty issue.

When we started to look at the data what we found stunned us. Michigan has the most expensive automobile insurance in the U.S., with an estimated annual premium in 2018 of \$2,610, almost double the national average. And with an average annual premium of \$5,414, Detroiters face the most expensive car insurance rates in the country.

The sticker shock prompted us to research how the State got here in the first place. The resulting policy brief, “Auto Insurance and Economic Mobility in Michigan: A Cycle of Poverty,” documents the problems and offers potential solutions for auto insurance reform in Michigan. I have included a copy of the policy brief with my written testimony for the record.

Michigan is not alone in facing rising auto insurance rates. In 2018, 184 million U.S. drivers, or nearly 4 out of every 5 drivers, faced a rate increase. In addition to Michigan, Louisiana, Rhode Island, and Florida also faced annual average premiums that are above \$2,000. The U.S. Treasury Department’s Federal Insurance Office deems auto insurance unaffordable in areas where premiums exceed 2 percent of a zip code’s median household-income.

Using recent data, we found that auto insurance rates represent more than 2 percent of median household-income in 97 percent of Michigan’s zip codes, yet the burden is substantially greater for lower-income and minority communities.

In places like Flint, rates eat up between 8 and 24 percent of residents’ pre-tax income and we also found that rural communities were especially hit hard by high rates; this matters because these communities deal with particularly poor roads and they have to drive longer distances for employment, which makes affordable transportation matter just that much more.

These costs make it harder for people to move up the economic ladder especially for low-income families, locked out of the auto insurance market by a lack of affordable coverage options. Take the case of a family where the household head is above the age of 65 and relies on Social Security as a primary source of income: in 2018, the maximum monthly Social Security benefit was \$2,788 a month, and it would take nearly 2 months’ worth of Social Security benefits to cover the annual cost of insurance in Detroit.

Why are rates so high? There are many factors at play, from broader economic trends to rising health care costs and differences in State regulatory practices, yet one reason why rates vary so considerably between drivers is that insurance companies use non-driving characteristics such as gender, zip code, and credit scores to set premiums for customers. It is reasonable to ask whether the

use of non-driving factors in setting premiums is unfair and whether there is potential for discrimination in rate setting.

Of these factors, credit scores are by far the biggest cost drivers for consumers, with rates more than doubling for those of poor versus excellent credit, thus a single mother in Detroit with a perfect driving record but bad credit could be charged one of the highest auto insurance premiums in the entire country.

What can be done? While numerous policy—to reduce auto rates, are typically from the purview of States, Congress has expressed interest in curtailing rate-setting practices at the Federal level. In our report we called on Michigan to curb the use of non-driving factors in setting rates following the model of several other States that already do this.

Prohibiting the use of all non-driving factors in rate setting may not be feasible as insurance companies must be able to develop actuarially sound models, however, other States have struck compromises on this. California, for example, has established reasonable rate-setting guidelines and prohibits the use of credit scores. Low-income drivers in cities pay nearly 60 percent more for auto insurance than high-income drivers.

In Los Angeles, the gap is only 9 percent, likely due to regulations placed on insurers. And in Hawaii, where the use of credit scores has been banned since 1987, the commissioner of insurance testified before Congress in 2007 that despite the ban, markets remained competitive and healthy.

In closing, with sensible reforms to our auto insurance policies, we can lower transportation costs and dramatically improve economic opportunity for families. Thank you, again, for inviting me to share my research findings with you.

I would be happy to answer any questions.

[The prepared statement of Mr. Rivera can be found on page 63 of the appendix.]

Chairman GREEN. Thank you.

Mr. James Lynch, you are now recognized for 5 minutes.

STATEMENT OF JAMES LYNCH, CHIEF ACTUARY, AND SENIOR VICE PRESIDENT, RESEARCH AND EDUCATION, INSURANCE INFORMATION INSTITUTE

Mr. LYNCH. Thank you.

I would like to take a moment to thank you, Representative Green, and the entire committee for giving me the opportunity to speak today.

My name is James Lynch. I am chief actuary and senior vice president of research and education at the Insurance Information Institute in New York. Founded in 1960, we are the trusted source of unique data-driven insights to inform and empower consumers.

Our members include 8 of the 10 largest personal auto insurance writers in the United States. We provide objective, fact-based information about insurance, information that is rooted in economic and actuarial soundness.

I am a fellow of the Casualty Actuarial Society, the leading property casualty actuarial organization in the world, and I serve on the Society's board of directors.

I have more than a quarter century of experience in property casualty insurance and reinsurance, and have held senior actuarial positions at QBE The Americas, and White Mountains Reinsurance of America.

And today I would like to discuss how companies set rates for automobile insurance.

Because of court cases and Federal legislation that stretch back decades, insurance companies are primarily regulated at the State level. Every insurance company must satisfy the laws and regulations of every State it operates in plus the District of Columbia, so most large insurers have 51 sets of laws to follow and 51 sets of regulators to satisfy.

Every State regulates what insurers can charge for personal auto insurance. State laws ensure that rates aren't too high because no State wants its consumers overcharged, or too low because if rates are too low, an insurance company might lack the funds to pay all the claims that it has said it will pay, and are lower for drivers who are less likely to be in a crash and higher for drivers who are more likely to be in a crash.

The company can only offer a discount if it can show that the customer is less likely than the average customer to suffer an insured loss; it can only surcharge if it can show the customer is more likely than the average customer to suffer a loss.

Insurers can't change rates daily or weekly, the way a grocery store can change the price of a gallon of milk. They must notify the State, usually beforehand, what they intend to charge. In some States, the department of insurance must explicitly approve changes in advance. The result is that auto insurance is not priced according to the law of supply and demand; it is a cost-plus product. Insurers estimate what they will pay out in claims then add in expenses and a reasonable profit.

In addition to State regulators, auto insurers operate in an extremely competitive environment and an important part of that competition is to develop sophisticated plans that properly assess each customer's likelihood of being in a crash.

Insurers use teams of actuaries to figure out how to set rates. They look for characteristics that successfully predict the accident rate, the most famous perhaps is driving record; drivers who have avoided accidents for several years are less likely to be in an accident in the future but driving record is not the only factor. The strongest by most accounts is location, which tells a lot about the number of vehicles per square mile, and just like with bumper cars, the more cars there are in an area, the more likely they are to crash into each other.

There are certain things that is important to know about these rating variables.

First, they work, they are effective at gauging the likelihood that a customer will be in an accident.

Second, they are selected after rigorous actuarial analysis; every rating variable has been proven effective through analysis of actual data.

Third, they are filed in advance with State regulators along with statistical proof of their effectiveness; in some States they must be approved in advance and they can't be changed without going

through the same regulatory process. Any Federal effort to oversee rating variables will overlap rigorous efforts that States already undertake.

Fourth, companies constantly review how effective these factors are. If they don't work in the world, they are adjusted or abandoned.

Fifth, the factors can change over time and actuaries adjust those factors as a result, for example gender, is a well-known commonly used variable and part of the reason it has been effective is that men drive more miles than women but that is changing. From 1963 to 2013, the number of miles the average man drove increased by about a third but the number of miles the average woman drove increased nearly 90 percent. The predictive power of gender as a rating variable has changed because the more miles you drive, the more likely you are to be in a crash and women are approaching men and sometimes exceeding men in that respect.

Sixth, insurers are constantly looking for new variables and when they find one, the new one can change how much emphasis is placed on the old ones.

And last, but certainly not least, the setting of private passenger auto insurance rates is a color-blind process. Insurers do not gather information based on race or income nor do they discriminate against anyone on the basis of race or income and they do not adjust the rates based upon any proxy for race or income.

Thank you for your time. And I would be happy to respond to any questions you may have.

[The prepared statement of Mr. Lynch can be found on page 57 of the appendix.]

Chairman GREEN. Thank you. And I thank all of the witnesses at this time.

Let me yield myself 5 minutes. And I would like to start with something very basic. Do you believe that testing is a means by which you can determine whether discrimination exists in auto lending? If so, would you just kindly extend a hand into the air, I would like to make a record?

I take it, Mr. Rivera, you do not believe that testing is a means by which we can determine whether discrimination exists?

Mr. RIVERA. The question in auto lending is a little bit outside of my purview so I will defer to the experts on auto lending.

Chairman GREEN. You will defer.

Mr. LYNCH. I am in the same boat.

Chairman GREEN. You will defer.

Mr. LYNCH. Auto lending is a little bit outside of my world.

Chairman GREEN. Well, persons who claim expertise—Ms. Clarke, Ms. Cross, and Mr. Van Alst—indicate that testing is a good tool.

With this tool, have we been able to validate the claims that this invidious discrimination exists as it relates to people of color and women?

Let me start with Mr. Van Alst.

Mr. VAN ALST. Testing that has happened more recently, looking at auto finance, has certainly been consistent with the findings of other analysis. I am more familiar with the use of large data sets to identify discrimination that has taken place and the report that

you referred to earlier from the National Fair Housing Alliance, found similar results using testing.

I will say in the auto arena, testing can be and is a good tool, but it is difficult, and in fact the National Fair Housing Alliance did have difficulty in getting straight information from dealers in order to make testing effective.

Chairman GREEN. Have you found that it is the markup that becomes the problem, the discretionary mark-up?

Mr. VAN ALST. I found that everything that is discretionary at the dealer level becomes a problem. We had certainly seen through litigation that these dealer interest-rate markups which are in addition to the interest rates already set based on risk pricing led to discrimination, and I want to say that dealers are understandably defensive when you point this out, and the fact that we see evidence of discrimination doesn't mean that dealers are necessarily overtly wanting to discriminate against races. I am sure, when you talk to dealers, they don't want to do that but they have to quickly size up someone and decide how far they can push them and what we see from the data is that what winds up happening is they use race to decide how far they can push someone in terms—

Chairman GREEN. Let me move to, Ms. Clarke, quickly. Ms. Clarke, give me your thoughts on the dealer markups, and we are talking about in addition to the pricing that has already taken place in terms of the lending?

Ms. CLARKE. So, matched-pair testing in the fair housing context has been a bedrock tool for identifying when landlords discriminate on the basis of race, ethnicity, or national origin and it is absolutely a powerful tool that can be used to identify when we are seeing potential discrimination rear its head in the auto lending industry as well. The National Fair Housing Alliance study that was released in 2018 did a very good job of deploying matched-pair testers out in Virginia and identified disparate treatment on the basis of race. Those black consumers who were exploring buying a car and accessing a loan were absolutely treated differently, they were given different information about the cost of loans, different information about the cost of the vehicle, different information about the markup, and we would not have been able to capture those differences in treatment unless we deployed in a very carefully controlled setting trained—

Chairman GREEN. Ms. Clarke, I am going to—

Ms. CLARKE. —testers.

Chairman GREEN. —have to ask you to wrap that one up and let me ask you another question that relates to the methodology used by the CFPB with surnames and geography to perform a study.

Can you give us your opinion about that, please, in terms of it being valid or not?

Ms. CLARKE. In my view, these kinds of studies and tests are one factor among many that we should look at in identifying discrimination. We do these kinds of analyses in the voting rights context, in the Title VII employment discrimination context, and once you have conducted an analysis that suggests you have identified discrimination, that is when you move further, you depose witnesses, you subpoena documents and get other evidence that might ultimately reveal and help you conclude whether or not you have a

lender engaged in unlawful discrimination, so it is one important factor.

Chairman GREEN. Has any court invalidated the study that the CFPB performed?

Ms. CLARKE. I am not aware of any court that has invalidated this study and I appreciate some of the questions and concerns that have been raised but again this is just one factor that should be further corroborated by testimony and other documents; further analysis of data that may reveal unlawful discrimination.

Chairman GREEN. Thank you.

I now recognize Ranking Member Barr for 5 minutes.

Mr. BARR. Thank you, Mr. Chairman.

And let me start with just making an observation, and maybe it is just me, or maybe it is just central Kentucky in my congressional district, and I certainly defer to the expertise of the panel who have studied this issue with great intensity, in terms of what you have seen, in terms of discrimination, racial discrimination in auto lending but in my experience, and again maybe this is just in my congressional district, I don't know a single racist auto dealer, I don't. I have never ever observed in my interaction with any auto dealer, a desire to not sell a car.

And in arranging financing, my experience in actually listening to my constituents of all races, is that auto dealers want to arrange financing and get a car moved off their lot and in the possession of their customers, regardless of race.

And what I would say also about the indirect lending model is that contrary to what we have heard today in a lot of the testimony, dealer-arranged financing helps, it doesn't hurt, consumers and customers and it does so because the dealer has the ability to have the scale and the purchasing power to actually interact with banks in a way that the consumer cannot.

The dealer has the ability to bring volume to a bank and arrange financing in a way that a cherry-picked customer cannot and so what I would say is remember dealer-arranged financing is a service, it is a service provided by the dealer that the customer may choose to use or choose not to use and no one is forced to use a dealer to arrange for financing, that is something that we haven't heard in the testimony here today. A car buyer opts, chooses to use dealer-assisted financing, he or she as a result receives a significantly more convenient buying experience and can achieve a lower interest rate.

Now, last Congress when we rolled back the CFPB's Indirect Auto Financing Guidance, in no way did we amend the fair credit Laws or hinder their enforcement. In fact, the National Automobile Dealers Association encourages dealers to adopt a robust DOJ-based Fair Credit Compliance Program and under this program dealers are required to be able to demonstrate through documentation any deviation in discount rates between individuals which must be based on legitimate business reasons.

I just wanted to make that statement and I invite the panel if they disagree with that, to talk about that in your testimony later.

But at this point let me move on to insurance and I want to first recognize my colleague from Michigan, the gentlelady from Michigan, for justifiably expressing concern about high rates in Michi-

gan. And Mr. Rivera, to that point and that issue in preparation for this hearing, I reviewed not only your testimony but also your report and op-ed on Michigan auto insurance rates that you released in March. After reading that report, I thought you made a very compelling case for the Michigan State Legislature to reconsider some of its policies, but nowhere in your written testimony did you mention Michigan's No-Fault Auto Insurance Mandate that is paired with the only unlimited personal injury protection (PIP) requirement in the country. Your report states that this No-Fault PIP requirement currently accounts for 42 percent of the average premiums paid by the Michigan driver.

On top of this, you state that Michigan does not impose a medical fee schedule resulting in the average auto accident claim in Michigan totaling over \$75,000, which is more than 5 times the average of the next closest State. Why is that information excluded from your testimony and don't you think that may be why Michigan premiums are so high?

Mr. RIVERA. Well, thank you for the excellent question. And thank you for reading the brief. As you know, we attached the brief to the written testimony and for the purposes of the written piece, really wanted to focus on what is really one of two issues: one is, why are rates so high just generally, and that is around the medical cost State practices that we all know so well; but then there is a second question, which is, why do rates differ between people? And that is where we really thought we had to incorporate this discussion around non-driving factors for the simple fact that you could get charged more if you lost your spouse, you could get charged more if you live in a rural area, and for factors like that we wanted to have a focus for the purposes of making sure that we also answered the prompt of the title of the testimony.

Mr. BARR. Mr. Lynch, in my remaining time, why do insurance companies use credit scores?

Mr. LYNCH. Because they are very effective. They work and they are very good at predicting how likely a person is to be in an accident in the coming 6 months or a year.

Mr. BARR. Is it ever used as a single variable to determine a rate or is it part of a larger algorithm?

Mr. LYNCH. No. It is always part of a larger algorithm.

Mr. BARR. And can you explain how consumers' prices would be effective, if insurers were not allowed to use that?

Mr. LYNCH. Well, then, what would happen is that for some people and by some measures most people their rates would go up and for other people their rates would come down and it would come to an average. In the State of Michigan, the average rate would be twice the average in the typical State but what would happen is that your drivers who present less risk would be in essence overcharged and people who are at greater risk of being in an accident would be undercharged.

Chairman GREEN. The gentleman's time has expired. The Chair now yields to the Chair of the Full Committee, Chairwoman Waters.

Chairwoman WATERS. Thank you very much, Mr. Chairman.

Since 1991, academic studies have demonstrated that when auto dealers have the discretion to mark up the interest rate on auto

loans, non-white borrowers are disproportionately harmed. Nearly 2 decades ago, the National Consumer Law Center brought several successful class actions that revealed racial disparities in dealer markups of interest rates.

I would like to ask, I think it is Mr. Van Alst, to describe this academic research and how prevalent such discriminatory markups happen; are you familiar with the research that was done?

Mr. VAN ALST. Yes. We were co-counsel in 12 cases that were litigated between 1998 and 2007. We analyzed millions of transactions. We coded these transactions for race based upon driver's license data. At the time we were involved in these cases, 14 States collected race information for driver's licenses and we were able to therefore code these transactions by race. This is something that can't be done today. I know we have had lots of discussion about data and lots of folks have indicated an interest to have good and accurate data, working on these problems but currently the Equal Credit Opportunity Act prohibits the collection of race data in these transactions and so we can't replicate today the same analysis that was done at the time this litigation took place.

Chairwoman WATERS. What year was this done?

Mr. VAN ALST. This was between 1998 and 2007 and so that is not only us but enforcement entities and States as well are both prohibited from collecting this data and prohibited from using that data because they don't have it, towards enforcement and this is a great hurdle whether we talk about State enforcement in this area or Federal enforcement, without the data, without knowing what is happening, we are forced to rely on—as has been pointed out—measures that are perhaps slightly less accurate than if we had good data about the race of people involved in these transactions.

Chairwoman WATERS. Do you have any studies or information, not polling data but stories that have been told by individuals about what happened to them when they went to purchase a car?

Mr. VAN ALST. I have reams of stories about abuses that people suffer when they go to purchase a car both from the time when I worked at Legal Services and since then when I have dealt with attorneys across the country, however very few consumers know that they have been discriminated against in terms of financing. This is not something that you can see, you can't tell that you were marked up 3 percent, your financing was, and the next person wasn't marked up at all, consumers have no way of knowing that this is happening to them, so I hear stories about all sorts of other things but consumers can never know that this is being done to them.

Chairwoman WATERS. But there are many stories in the African-American community about how they were treated when they went to buy a car and now, some African-American consumers will ask someone to go with them because of the way they have been basically abused, they have been bullied, they have been lied to, and so these stories are legendary about what happens to African Americans and women when they are trying to purchase a car.

And I know that the members of this committee, every member of this committee has heard these stories about what happens when women and people of color and African Americans go to pur-

chase a car. So I wanted to find out a little bit about that study and perhaps what we need to do to keep proving, to keep giving the information because it is not that this is not happening, it is because the auto dealers have a lot of influence in this Congress, and Members who believe it is their responsibility to protect the automobile dealers and not the consumers and so this is a very difficult issue.

You saw what happened before when it came before this committee and you saw how they rolled out the lobbyists, how they put the money into the campaigns, and you saw the results coming out and so this is difficult work and we have to keep doing it, we have to keep finding ways to get more information and not just rely even on the stories that we hear oftentimes but the fact that this has to change.

I yield back the balance of my time.

Chairman GREEN. The gentlelady yields back.

The Chair now recognizes the gentleman from Florida, Mr. Posey, for 5 minutes.

Mr. POSEY. Thank you, Mr. Chairman, and Ranking Member Barr, for holding this hearing today. There is no place for discrimination against any American citizens. Allowing discrimination to persist would dishonor those who fought so bravely to defend our nation and currently are online to do so, we all abhor discrimination clearly.

For today's hearing I think we ought to follow the principle of evidence-based decision-making. Evidence-based decision-making encourages us to look beyond first impressions, not for the purpose of dismissing concerns but to reach a deeper understanding on why something is the way that it is and that is what we must do to solve problems like we have before us today. That is the spirit I believe we ought to have in approaching today's hearing; we must collaborate to see the full story with respect to auto insurance and markups of auto insurance interest rates. Often, there is more going on than first impressions might tell us.

Perhaps a solution is something different than calling the usual cast of regulators and sending them forth. We would all find it reasonable that a business seeking profits probably shouldn't care about ethnicity, age, or gender of their customers. Clearly, a business shouldn't make any more money by merely charging more for certain groups and market economy with competition we have in this country, ought to result in a person taking his business elsewhere and for businesses competing for this business to offer him a better deal than someone who discriminates. Now, that is how we expect the markets to work and our competition usually drives down prices for everyone.

For the panelists, if the differences we see in the auto insurance rates in the interest markups are solely due to ethnic, age, or gender bias, why doesn't the marketing competition drive these practices out of existence?

And we usually start from left to right, so let us start from right and go back left today.

Mr. LYNCH. That is your right?

Mr. POSEY. Yes.

Mr. LYNCH. Okay. So insurance companies—a lot of the discussion today has involved the use of the word “discretion,” and once insurance companies have made their determinations based upon the risks that they see and the data that they observe year in, and year out, once those rates are set for automobile insurance, the world of discretion ends; there is no discretion left, the rate is what the rate is and it is based upon the characteristics that any customer presents and those and all of those have been linked to higher or lower propensity to be in an accident and that is simply how insurance is priced and how insurance is done and once that is in place, in auto insurance there is no more discretion.

Mr. POSEY. Okay. Thank you.

Mr. Rivera?

Mr. RIVERA. Hello, thank you for the question. Some of the factors used in auto insurance have been found to not be correlated with risk. There are certainly non-driving factors you want to consider; they need to be included for insurance companies to have sound rates. A good example of this is gender, the way in which it is treated has been found in research to vary from company to company in which sometimes you get a discount, and other times you get charged a little more. It also varies by State and it is this inconsistent application that could be potentially unfair for the consumer going from one State or another to have their gender matter differently, as one potential way in which risk might not be fair.

Another is the use of things like credit scores. I agree with my colleague that credit scores are not correlated with race but we have to ask the question, why people of color are disproportionately represented in the ranks of Americans with poor or no credit and it is not because they lack financial skills, it is because of systemic, sometimes implicit discrimination that happens elsewhere in the market that ends up showing at things like credit scores.

So I would say well, I think there are compromise factors looking State to State they have looked at it, there are certainly some factors that deserve a little more scrutiny for thinking about what their basis really is, and I think for insurance companies themselves, that transparency is not always available to consumers. It is often very hard to get information about what factors they are using and one of the biggest factors that can weaken a good free market is imperfect information.

Mr. POSEY. Thank you.

Ms. Clarke?

Ms. CLARKE. The foreclosure crisis and resulting recession resulted from us relying on the market frankly and from insufficient oversight and regulation on banks that were peddling sub-prime and predatory mortgage products to consumers, many of them people of color. Likewise, in the auto industry, we don't want to return to that era. We need strong Federal oversight and regulation to ensure that consumers are being treated fairly and equitably and most importantly to ensure that practices like markups are not rearing their ugly head.

Mr. POSEY. Thank you.

Ms. Cross?

Ms. CROSS. One reason perhaps that the market hasn't corrected this so to speak is because a lot of times borrowers with poor credit

histories or in areas of other disadvantaged situations know that they have no other option and that puts them in a very vulnerable state when they go to buy a car and to get financing, to be kind of at the will of creditors who know that they are able to take advantage of that situation.

Mr. POSEY. Okay.

Mr. VAN ALST. Another reason that competition hasn't cured these problems is that this is not a transparent and clear marketplace; you have to actually spend hours at the dealership to even find out what terms you will eventually be offered, typically you have to have already gone through the sales process back at the F&I Office before you can even find out what sort of finance terms are going to be offered, so it is much more difficult to do comparison shopping unless you are prepared to spend days and days to try to go from one dealer to another.

Mr. POSEY. Thank you, Mr. Chairman.

Chairman GREEN. The Chair was quite liberal with the time; the gentleman yields back.

The gentlewoman from Michigan, Ms. Tlaib, is recognized for 5 minutes.

Ms. TLAIB. Thank you, Mr. Chairman.

Thank you so much, Mr. Rivera, for being here. Would it surprise you to know that a driver with a DUI and a good credit score will pay less for auto insurance than a driver with no DUI and a good driving history who has a decent credit score, not so great?

Mr. RIVERA. When I found out I was shocked, yes.

Ms. TLAIB. Tell us a little bit more about that? I want you to tell people here, the non-driving factor, the use of a credit score, a person who committed DUIs who has a really bad driving history compared to somebody who doesn't have a great credit score but for the fact that—and let me tell you I have seen people's credit scores impacted by the fact they have become a widow, that they are retired, I know a woman who worked at Beaumont Hospital for 25 years, had been driving for 55 years, and when she retired, her car insurance went up \$350, and when she called, they said it was because her credit score was impacted, however she is driving less, she is not getting any tickets, so how is this legal? How is this possible?

Mr. RIVERA. Yes. So some of the research has said that one of the reasons why credit scores are a factor is it predicts the likelihood of a claim but we really need to unpack that. Why do folks with low credit scores need to make a claim? And the answer to that is, think about the situation that gets you to there in the first place; for many Americans, their credit score is influenced by factors outside of their control, a family emergency, loss of a spouse, getting behind because of the high cost of college or education, and for those—

Ms. TLAIB. But Mr. Rivera, they are saying if somebody has a low credit score, the likelihood of them committing a fraudulent claim is higher, so they are saying because they are poor, because they have a low credit score, the likelihood of them committing a crime is higher, isn't that discrimination?

Mr. RIVERA. Yes, I believe so. It disproportionately impacts low-income, working-class families.

Ms. TLAIB. That is right.

So Mr. Lynch, there are two drivers, true fact, who can talk to each other from across the street in their driveways, they are the same age, they have the same driving history, the same car, the same credit score, what I can't figure out is why a driver who lives in Detroit on the side of Mack Avenue gets quoted double the price for basic minimum coverage than a driver who lives right across the street on Mack Avenue on the Grosse Pointe Side?

Mr. Lynch, can you explain why it is determined by the auto insurance industry that that side of the street pays \$3,000 more per year than the driver in the Grosse Pointe area?

Mr. LYNCH. That is because of the way that the territories have been drawn and those—

Ms. TLAIB. But you are basing it on zip codes, right, not driving history and driving record, say it, you are using—

Mr. LYNCH. It is being—

Ms. TLAIB. —zip codes.

Mr. LYNCH. —based upon the territory which is the zip, the—

Ms. TLAIB. Zip codes.

Mr. LYNCH. —codes are usually used to determine what the territories are, those territory factors, the boundaries of them, are being constantly reevaluated by insurers and in fact one of the things that insurance companies are trying to get a better handle on, is something called, I think it is called geospatial coding which is the use of the exact longitude and latitude to set rates so that some of those—

Ms. TLAIB. Mr. Lynch—

Mr. LYNCH. —discrepancies—

Ms. TLAIB. We call that redlining. It is a discriminatory practice to base it not solely on people's driving history. And the non-driving factors are hurting families.

And I really do have a question for Mr. Rivera because I have limited—Mr. Rivera, what research did you find in the difference between the rates between zip codes? Because I know according to the Consumer Federation of America, a zip code in Detroit with an 8 percent white population adjacent to zip codes with 85 percent white population pays 65 percent more in auto insurance, is that correct?

Mr. RIVERA. That is correct.

Ms. TLAIB. For instance, even though we are talking about this being a white-black issue, and we have talked about this, I don't see this as a white-black issue anymore, I am talking to people and it is true, African Americans in my district pay a lot more but what I am showing now is that 97 percent of Michigan's zip codes pay unaffordable car insurance rates.

This has nothing to do with no-fault. These are non-driving factors. They are using gender and Mr. Rivera, when you talked about gender, I was a little taken aback, you are saying that someone, a woman and a man, you are using that as a factor in calculating rates, not where a person works, and you asked us where we work and you calculate the length of the driving between your home and your workplace, so why isn't that used? Why are gender and people's marital status and their credit score being used to calculate rates?

Mr. RIVERA. Well, from my perspective, they shouldn't be. They are being used because insurance companies think that those folks will file more claims and they want to charge them more and the unfortunate effect of this is that the people who need the cheapest auto insurance the most, are the ones who get charged more and those in relatively wealthy areas, relatively wider areas who have relative privileges, get charged less, despite the fact that they could afford it.

Ms. TLAI. And lastly, Mr. Chairman, if I may, I did pass out and ranked so you all can see this is not just a Michigan issue, but car insurance rates are high risk especially with a lot of our residents. The use of non-driving factors is really putting more people into poverty and it is something that our families are facing every single day. And so, I did pass out the ranking from Florida to Kentucky to New York and Ohio.

So I hope my colleagues consider this as they look at the bill that I have right now, that prohibits the use of credit scoring in calculating car insurance rates.

Thank you, Mr. Chairman.

Chairman GREEN. Thank you. The gentlelady's time has expired.

The Chair now recognizes the gentleman from Georgia, Mr. Loudermilk, for 5 minutes.

Mr. LOUDERMILK. Thank you, Mr. Chairman.

I thank everyone on the panel for being here today. This is an issue we need to address but it is an interesting issue, in that most if not all of our States by law require drivers to have some form of auto insurance, and as someone who has recently been involved in a very bad accident, was hit by someone who had no insurance, it is obvious to me why we do require people to have insurance.

On the other hand, insurance is not a one-size-fits-all thing, and what I found through my experience in life is when you have a one-size-fits-all, it is only one very narrow segment of a consumer base that it fits; everyone else is then harmed in some way or the other because it doesn't fit where they are and insurance is one of those areas that I see that with one-size-fits-all, is generally going to raise the price for everyone and when that price goes up, those who come from low-income families, as I grew up, are harmed the most, and so that is my concern of where we are going in all of this and my serious concern over the proposed bill.

Mr. Lynch, I understand we do use credit ratings which, from the information that I have derived, is a fairly accurate way of—not the sole way but a way of helping to determine a risk factor because insurance is all about risk. I remember growing up that if you were a male, you were going to pay more in car insurance up until you were 25-years-old; I don't know if that is still the case. I remember when I turned 25, that was a magic age of, now I get cheaper insurance, and it happened, even though my wife, she was already you know, she was a less risk her car, she paid a little less on it because I guess statistics showed that men had a little heavier foot than women did.

The point I have is—my understanding of the rates in insurance are based on multiple risk factors because you do not have a crystal ball, you cannot sit down and predict if someone is going to have an accident at some time and is it going to be their fault so

you have to have tools and I know it has been touched on already, but how does the credit rating apply in helping to make those determinations of risk as you also use other tools, how do they work together?

Mr. LYNCH. It is a type of analysis that actually has become a lot more sophisticated in recent years. One of the things that actuaries have gotten really good at is understanding how those individual rating factors interact and overlap or miss each other and so they adjust rates for that, so for example when you see the kind of a one-way analysis that you have seen with gender rating in particular, where you take six factors and hold them constant and then only change gender, when you go from community to community, that does give you a window but you can't project forward and extrapolate that experience to all women who are drivers.

Mr. LOUDERMILK. Right.

Mr. LYNCH. You can't do that because you haven't done anything to take into account that interaction. I can also state that all of these variables, all of them are constantly being reassessed by insurance companies. Gender was one that specifically insurance companies are currently looking very closely at because we are starting to understand the nature of gender identification in a very different way that we did even 10 years ago. And insurance companies have their eyes open, and they see those things as they are happening. And so they are working hard to make sure that their rating plans take that into account.

And then as women have been driving more in recent years, that relationship between men and women, which at one time was thought to be exclusively because men have a heavier foot than women, it actually is being shown to be at least in some of the cases it appears to be just the number of miles being driven.

Mr. LOUDERMILK. Okay.

Mr. LYNCH. The number of miles you are on the road tells you how likely you are to be in an accident, which is kind of a—

Mr. LOUDERMILK. Don't most States who have the predominant regulatory impact on insurance require that you only use risk-based factors in determining—

Mr. LYNCH. Yes.

Mr. LOUDERMILK. Okay.

So quickly, Mr. Rivera, you revealed that there may be some discrimination in the actual credit reporting which is not directly effective on the insurance agency, shouldn't we focus on that, not eliminating the insurance companies from using something that is a tool, address the discrimination on the credit report side not eliminate their ability to use a tool?

Mr. RIVERA. I think it has to be examined because just because something is a risk factor, it doesn't mean that the reason for why it creates a risk factor is justifiable. In the case of credit scores, it might be correlated with risk, but you want to unpack it and I think as you know, I have kind of talked to today, some of the reasons for why it can become a risk factor are actually reasons that we may not want to penalize when it comes to pricing, there are certain consumers.

Mr. LOUDERMILK. Thank you. I yield back.

Chairman GREEN. The time has expired.

The Chair now recognizes the gentlewoman from Ohio, Mrs. Beatty, who is also the Chair of our Subcommittee on Diversity and Inclusion. She is recognized for 5 minutes.

Mrs. BEATTY. Thank you very much, Mr. Chairman.

And thank you to all of our witnesses here today.

I am not sure where I should start with this, after reading everyone's testimony. Certainly, I associate myself with much of everything that Congresswoman Tlaib has said.

You probably can tell by our tone that it is a subject that we want to weigh in on very much because when you talk about discrimination in any field, when you talk about disparities that we should be able to change, when you cite information in testimony and reports that oftentimes don't match up or you highlight things that don't make sense, it puts me on pause of, where do I start?

So Mr. Rivera, you are up first. In your report you cited the findings by the Federal Insurance Office that nearly 19 million people live in zip codes where auto insurance is unaffordable, 19 million people out of 327 million people, meaning about 6 percent of the American people live in zip codes with unaffordable insurance. Now, you also stated, if we compare that with Michigan where you state 97 percent of the people live in zip codes with unaffordable insurance, now, you know, I am from Ohio, so I am not picking on you because it is Michigan, I am just giving you back what you gave to us, this to me seems like a Michigan problem. Why should we use Michigan, with its deeply flawed system, as evidence that the Federal Government needs to usurp State laws and change how insurance rates are calculated, explain that to me?

Mr. RIVERA. Of course. There are two questions there that I will think through.

The first is that the question of jurisdiction is a question that I will leave open to Congress and it is not the subject of my expertise.

The second is, I can provide recommendations for what could be done at any level of government. And I think Michigan is the canary in the coal mine; I don't think it is alone. You see rising insurance rates throughout the country and you see working-class drivers struggling to pay rates. And a part of that factor is the use of non-driving factors.

So as Congress considers the policy levers in front of it, we have attempted to provide the best evidence for the case for or against, looking at those factors.

Mrs. BEATTY. Okay. Mr. Van Alst, let me just say, any time we are using zip codes, that poses a problem to me. People should not be judged, in my opinion, by their zip codes, their addresses, and where they live, but there was a bill that came up in our 114th Congress where we dealt with this, and it was a system that was used, the Bayesian Improved Surname Geocoding (BISG) methodology, and it used race and zip codes, so let me ask you, between 2003 and 2007, the National Consumer Law Center settled for more than \$100 million on related class-action suits so I am going to ask you, did you use the BISG Methodology in that suit and if not, what did you use?

And part of the reason, it was interesting as I was reviewing some of the testimonies here, I plugged in my surname and every-

thing they asked me for, and it came up that there was an 80.24 percent chance that I was white. Now, clearly, saying there was an 80 percent chance that I was white by that zip code, the system is flawed when you do that, and conversely for a whole lot of people it would come up and actually maybe they are poor and maybe that they do live in an area and it will work against them and so I am curious, what system do you use? Because I am going to plug my name and address in and see what happens.

Mr. VAN ALST. In our litigation, what we actually did was pull race data that folks reported themselves to their State DMV or RMV when they got their driver's license. At the time we were doing our litigation, there were 14 States in the U.S. that collected race data, and because people move around, we were able to use that data to get statistically significant results in a number of States beyond those 14. That is no longer the case, those States no longer collect race data. There are issues with using surname and geocoding as a proxy for race. I think the CFPB and others certainly agree that there are issues with that unfortunately because the Equal Credit Opportunity—

Mrs. BEATTY. I am going to have to stop because my time is running out, and I just want to quickly say, it works two ways because it could not only hurt African Americans but also benefit folks who might not be a minority, who live in a minority neighborhood.

Thank you, Mr. Chairman. And I know my time is up.

Chairman GREEN. The gentlelady's time has expired.

The gentleman from Ohio, Mr. Davidson, is recognized for 5 minutes.

Mr. DAVIDSON. Thank you, Mr. Chairman.

And I thank our witnesses.

And following my colleague from Ohio, I have a similar observation about the difference between Ohio and Michigan, and we are not talking football but with insurance. If you look at the consequences. Ohio is less than half the cost for comparable coverage, and we are here talking about laws and public policy because laws and public policy have consequences and you can see clear differences in the policy requirements to write a policy in Michigan versus to write a policy in Ohio and that is embedded in the price.

I have appreciated the education in preparation for this hearing and in the dialogue here about other factors that are going into the pricing and I guess some differences of opinion about how those factors are affecting the price.

But Mr. Rivera, at the core, when you write a policy in Detroit, and you write a policy in Cleveland, Ohio, they are demographically very similar, so isn't the core price difference between the two States the content of the policy?

Mr. RIVERA. Well, certainly State-by-State trends impact the cost of auto insurance but for drivers in both Toledo and Detroit, their credit score or their gender can also impact their price, which is something that they share in common.

Mr. DAVIDSON. Okay. So there are factors that can influence it.

But Mr. Lynch, as you look at these generic things like sex, gender, zip code, things like that that are not personalized, when you look at the rate differences on insurance, there are some people who are advocating for, everybody gets a policy, you get a policy

and you get a policy and you get a policy, and it doesn't really matter what your driving records are like and we just want to average-price it, so everybody shares the risk which produces more risk in the pool and no one could be denied the ability to buy insurance or even have to pay a higher price.

Why would we do that? Why wouldn't we say, you are a safe driver so you will pay less than somebody who is not a safe driver?

If someone has 5 speeding tickets and a DUI, isn't it rational that this person would pay more than somebody who has never had a moving violation?

Mr. LYNCH. Well, driving record is used to evaluate whether a person is a good risk. It is one variable, but it is not the best predictor of risk, and that is a simple fact.

I did a simple one-off analysis about the percentage of cars that were in an accident and the percentage of people who get a moving violation in a year. And I figured out that about 75 percent of Americans probably got a discount for good driving because they haven't had either of those happen in the last 3 years. So that would be 3 out of 4 people in this room getting that discount and there is a lot more to whether you are going to be likely to be in an accident than that.

I have talked to some people, and that is actually kind of reflective of what the industry really is. The strongest predictor, the absolute strongest predictor is the number of cars in a territory, because the more cars there are per square mile, the more likely they are to bump into each other. And I live in New Jersey where we have about the highest rates in the nation and we have the highest vehicle density in the nation and that is no coincidence.

Mr. DAVIDSON. Right. So when you do that, even though you have all these other factors for the individual, you inherently have to come back to something like zip code, something like who drives through this area here and what kind of vehicle, the price for insurance for certain types of vehicles, that influences what kind of car you drive, that also affects your rate, correct?

Mr. LYNCH. Depending on the package of coverages of auto insurance, that can make a significant difference. Obviously, it costs more to have first-party coverage on, say, a \$50,000 car than it does on a car that you got secondhand for \$1,000 or \$2,000 or \$4,000.

Mr. DAVIDSON. Correct. And then my understanding is when you look at data analytics and of the panelists it seems that your organization would be in the best position to offer perspective on the data that is collected. Data is increasingly monetized. And I assume many of your companies are purchasing and acquiring data that allows for highly personalized pricing based off of a whole variety of data analytics.

Can you comment on that please?

Mr. LYNCH. Well, yes. Data is critical and data is very expensive. It is very expensive to prepare the dataset, it is very expensive to preserve it. We did some work in the State of Florida and just cleaned up a small database of only about 300,000 records which is quite small and only about 10 variables and it cost us \$15,000 for about 3-months' worth of work at the Triple-I.

It is very expensive to maintain a dataset, and companies don't do that unless they can get actionable and important information from it. And that is why we developed the sets of rating factors that we developed; if it wasn't necessary to do that, in all likelihood it wouldn't happen.

Mr. DAVIDSON. Thank you.

My time has expired, and I yield back.

Chairman GREEN. The gentleman's time has expired.

We will now recognize the gentlewoman from Texas, Ms. Garcia, for 5 minutes.

Ms. GARCIA OF TEXAS. Thank you, Mr. Chairman. And thank you for putting this hearing together. I think it is a very important topic and I know that as a former Legal Aid lawyer in the consumer section, I certainly understand a lot of the issues that face particularly a lot of working-class people in my district, and it is sad to note that these issues were there many years ago and they are still here today.

So thank you to all the panel for being here because this is something that directly impacts so many of us in and around Texas.

But Mr. Chairman, I know that my colleague from Michigan has followed this issue because she is after all from the place where the cars are built, so I yield the rest of my time to my colleague from Michigan, Ms. Tlaib.

Ms. TLAIB. Thank you so much.

So Mr. Lynch, why does marital status have anything to do with somebody's driving history or driving record?

Mr. LYNCH. It is one of many factors that insurance companies have looked at, in that case, over the course of decades and determined that in certain conditions and in combination with other factors, it can make a difference as to how likely a person is to be in an accident.

Ms. TLAIB. So Mr. Rivera, one of the things that I talked about is obviously the use of credit scores and the fact that I think a lot of my colleagues on both sides are agreeing that there is some flawed system to credit scoring, and I appreciate them saying that.

I will tell you a story about somebody in my district who, at a very young age, went and served our country, and came back, and of course didn't build up their credit, through no fault of their own, and is trying to build up their credit as they come back after serving, after driving Humvees in Iraq. And they come here and they try to get car insurance and their credit score is being used as a factor—not where they live, the distance between their job and their workplace or any other driving history because they have been driving since they were 16.

Again, I really want to unpack this idea around the use of non-driving factors because I do think even if we fix whatever other issues are going on, there are layers of issues when it comes to insurance coverage on home and auto but this use of non-driving factors, to me, is a really dangerous loophole in that we on the Federal level have a responsibility to push back against especially corporations using these factors because they are a factor to get around obviously the accountability of making sure it is fair and just for everyone.

And as a woman, as soon as I am divorced, my credit score drops, even though I am still making the same amount of money—it just drops. The use of credit scores to me is extremely dangerous.

And I want Mr. Rivera to really dive in and talk about this unpacking, around the use of credit scoring.

Mr. RIVERA. Yes. Well, in many instances it can be egregious, particularly when you think about, a credit score is not just a reflection of your financial acumen, it is a question of what opportunity you have in the market. And in many hearings that I have been to before this very committee, there is rampant evidence of discrimination and a whole host of markets that lead one to have a bad credit score.

I will give you one example of something that is just down the block from me, there is something called L.A. Insurance. They used to sell 7-day insurance, it was a way of charging you an extremely expensive package just so you can meet your obligations to this State and then when the State took action against 7-day insurance, they started selling 6-month insurance. And if you called them, they said hey—

Ms. TLAIB. Thirteen days, too.

Mr. RIVERA. Thirteen days. And if you called them and you got on the phone with them, like I did, you would ask, hey, do I really need to have this for 6 months? And they kind of say, no, cancel it after this, once you send us the check.

So in many ways, minority communities, low-income communities, just get up-charged every step of the way before they even get to the auto insurance policy and so it is only salt in the wound when the credit score is used again to determine their rate.

Ms. TLAIB. So Mr. Lynch by and large, the insurance industry has never admitted that communities of color actually pay more for their car insurance, in fact they often become downright defensive about it. According to the balance in 2014, the National Association of Mutual Insurance Companies sent a letter—and I have it here and I would like to submit it for the record.

The Federal Insurance Office insinuated that people of color can afford to pay more for car insurance because—wait for it—they spend money on their pets, toys, alcohol, tobacco, and recording equipment. Is that true?

Mr. LYNCH. What are you asking?

Ms. TLAIB. Do you know about this letter?

Mr. LYNCH. I had nothing to do with composing that letter. But that letter does exist. And the minute I saw it, I thought, what could you possibly be thinking, that is not the—

Ms. TLAIB. But doesn't that—

Mr. LYNCH. —way—

Ms. TLAIB. —already ensure—

Mr. LYNCH. —the world operates.

Ms. TLAIB. And I am sorry, Mr. Chairman, doesn't that already ensure they are using discriminatory—they are thinking of my people of color, in America, in this way, that they would, to use that as a basis.

Mr. LYNCH. I get where you are coming from, I really do because when I saw the hole it put in your stomach, it put it in mine as well.

But I can tell you that the insurance industry doesn't operate that way and that was just an unfortunate and gross exception to the way that the industry normally operates. And you know what? We had nothing to do with that statement but I personally and sincerely apologize that any person here was subjected to that kind of thinking.

Ms. TLAIB. Well, Mr. Lynch, I—

Chairman GREEN. The gentlewoman's—

Ms. TLAIB. —appreciate that you acknowledge that.

Chairman GREEN. —time has expired. But please—

Ms. TLAIB. I do ask, Mr. Chairman, unanimous consent to insert for the record the letter—

Chairman GREEN. It will be admitted, as well as your other document styled, "Auto Insurance Rate Oversight and Reform Subcommittee Members State by State." Do you desire to have that in the record?

Ms. TLAIB. Thank you, yes.

Chairman GREEN. Without objection, it is so ordered.

The Chair will now recognize the gentleman from Tennessee, Mr. Rose, for 5 minutes.

Mr. ROSE. Thank you, Chairman Green, for calling this hearing. And I appreciate the opportunity to hear from the witnesses today.

I understand my colleagues' concerns about the high prices in Michigan and concern that those prices may be impacted by certain demographics, by non-driving factors like income level, but Cleveland and Detroit are fairly similar in terms of demographics and income level yet Cleveland has dramatically lower insurance premium rates. According to Mr. Rivera's report, in Cleveland the average annual insurance premium is \$1,277, while in Detroit the average premium is \$5,414.

Mr. Lynch, can the conditions that you have described in Michigan such as the no-fault insurance law partly explain the difference in insurance rates between Cleveland and Detroit?

Mr. LYNCH. That is an enormous part of the difference. No-fault automobile insurance—when actuaries look at all the different States, they look at the State of Michigan completely separate from the rest of the country because the laws there are drawn differently for auto insurance than they are anywhere else, and that is just a statement of a projective fact, it is not a value judgment. It is the most generous system in terms of claim payments.

For a no-fault auto insurance claim, the limit on payments is infinity, it can be \$5 million, it can be \$10 million, it can be \$20 million. And there are claims that come through of that size.

In other States where no-fault exists, and it doesn't exist in most States, but where no-fault does exist, typically the limit is somewhere between \$10,000 and \$15,000, so when that \$10 million claim comes through, the auto insurer pays the \$10,000 or whatever their limit is and then it moves over into the health insurance system.

But in Michigan, especially if you are dealing with Medicare or Medicaid, those types of insurance have any other insurance pay first, so if a 65-year-old was involved in a terrible accident in Michigan, they are going to get coverage first from the no-fault pol-

icy and it is going to pay and pay and pay forever and then they will never touch the Medicare.

What that means is that insurance is a cost-plus product. Insurers estimate what the cost of claims is going to be and then they add in provisions to cover agents' commissions and taxes and licenses and fees and a reasonable provision for profit and when you do that, when you have an infinite limit, you know you are going to have a higher rate than you have in a State like Ohio where I don't believe it is a no-fault State. And I believe on liability coverages, the minimum limit is around \$35,000 to \$60,000.

So the difference between a \$60,000 claim and a \$10 million claim is going to have a big influence on how much money every person in the State pays regardless of how that rate is arrived at.

Mr. ROSE. Thank you.

Before coming to Congress, I was a private businessman, and also served briefly as Tennessee's Commissioner of Agriculture. I tend to think that government and regulation work best the closer they are to the parties being governed and regulated. The insurance industry is one of the few success stories in that it hasn't been swallowed whole by Washington.

We have been regulating insurance at the State level for over 150 years, and it is a system that works for consumers in terms of accessibility and affordability. Members from both parties seem to agree on this. Even when crafting the Dodd-Frank Act and creating the CFPB, Democrats on this very committee stipulated that the CFPB was not an insurance regulator, they didn't want to supersede State-based insurance laws and commissioners.

Like them, I am opposed to any potential overreach by Congress that diminishes a State's right to regulate insurance. I believe H.R. 1756 represents such an encroachment by Washington. Of all 50 States, only 3 have decided to prohibit the use of credit-scoring data in auto insurance underwriting: California; Massachusetts; and Hawaii. Now, I might disagree with their decisions because I think that data helps better price the product for consumers but that is the decision those State regulators have made and legislatures and government legislators and governors have made and I respect it.

Tennessee and Michigan or any of the other 45 States could make the same decision, but it is their decision not ours, and I hope it remains that way. Thank you.

And I yield back.

Chairman GREEN. The gentleman's time has expired.

The Chair now recognizes the gentleman from New York, Mr. Zeldin, for 5 minutes.

Mr. ZELDIN. Thank you, Mr. Chairman.

I represent a district on Long Island in the State of New York. It is very difficult there, as it is in many other parts of the country, to get around without a car, whether it be to try to get to school or to try to get to work.

Access to affordable financing and insurance is what helps them have that opportunity to have a car that can get them to work or to school. This isn't a wonky policy debate that we are having here; it really impacts each and every one of their lives very personally.

In real life, absent a government takeover of the lending market, you always have divergent auto lending rates for different borrowers based on creditworthiness, the term of the loan, the price of the car, and the difference between State laws and regulations. Now more than ever, consumers can shop around, compare rates, and get the best deal.

It is so critical and it has been said over the course of the hearing today that any discrimination related to race, gender, or ethnicity is entirely unacceptable. Extorting honest lenders and using spurious statistics to justify those attacks that some of what we are getting into here during this this hearing could hurt the very people we are supposed to be helping so it is very important to have the best possible data when reaching our conclusions that we are talking about.

Using questionable disparate-impacted data means no actual discrimination has to be proven or occur for what could be a politically motivated lawsuit, it could be a bureaucratic attack to shut down an honest lender or an auto dealer. Meanwhile, rates go up and access to credit goes down and consumers, especially low-income ones, will suffer. When it comes to flawed mandates on auto insurance, we have also had State policies that I briefly mentioned earlier, that have led to rates skyrocketing, so any attempt to do that at the Federal level could be very problematic.

My question first, for Mr. Lynch is, we have been talking about the State of Michigan a lot today and that is good. The State of Michigan mandates unlimited personal injury protection (PIP) and no-fault auto insurance. There are people at home who don't live in the State of Michigan, and they are listening to today's hearing. So, what does that mean? Can you explain it to them? And do any other States in the country do that?

Mr. LYNCH. Yes. They are about—and unfortunately, I didn't prep myself on that exact question but there are about a dozen States that have some form of no-fault automobile insurance. The idea of no-fault is that it kind of usurps the idea of liability and claims. A typical claim—we always think, who is at fault in the accident, and whoever is at fault pays in the accident, but in States like Michigan, the alternative for medical injuries is no-fault insurance so it doesn't matter if you are in an accident and you are injured in the accident, it doesn't matter if you are at fault or not at fault, the insurance responds and pays so that that is the difference between no-fault and a typical tort system, which I believe is the case in Ohio, which is the other State that seems to have come up in a number of comparisons.

Mr. ZELDIN. The average cost of an automobile accident insurance claim in Detroit in 2017 was \$51,000. Is that normal?

Mr. LYNCH. I would guess it is normal for Detroit but it is not normal for the rest of the country.

Mr. ZELDIN. Can you explain, I guess tied to the first question, how that mandate impacts the rates?

Mr. LYNCH. Well, what happens is no-fault is not the cause of that high rate. The actual cause is the fact that the no-fault is unlimited, so when you say a \$50,000 claim, that is obviously an agglomeration of some small claims and some medium-sized claims and some large claims, and in Michigan, because of the no-fault

law, the large claims can get really, really large, in fact there is an entire insurance entity that is ultimately responsible for claims that exceed I believe \$550,000, no-fault claims and that is above what virtually any personal automobile insurance policy in the United States is, except for in Michigan.

Mr. ZELDIN. Mr. Rivera, your report got into—and I guess this question is for you and maybe Mr. Lynch but we only have a few seconds—a whole lot of different reasons why the Michigan rate in the State is so high. Can you speak to what that would do for the rest of the country if the Michigan model was used elsewhere around the country as far as what, in your report causes the high rates?

Mr. RIVERA. I would hate to extrapolate given that there are vast differences State by State but I do believe that the research cited by Mr. Lynch on this question of personal injury protection claims is worth considering as was in the brief I think, they play a part in averages, they can explain differences between people, which I think is the focus.

Chairman GREEN. The gentleman's time has expired.

The Chair recognizes the gentleman from Wisconsin, Mr. Steil, for 5 minutes.

Mr. STEIL. Thank you very much. And Mr. Chairman, thank you for holding today's hearing on what is a really important topic. There is no place for discrimination in our system across the board and I think we are identifying that here today.

I also want to talk about the high rates of insurance and where, as policy folks, we can dive in to try to drive the cost of insurance down for everyone so everyone could benefit. I think the State-based insurance regulations allow us to compare how different policies work and apply those lessons to other States. We have come to observe these policy decisions yield sometimes bad outcomes for customers.

I am from the State of Wisconsin, which actually has the second lowest insurance rate in the nation, averaging \$951. We share a border with Michigan so snow in Wisconsin, snow in Michigan, sunny day in Wisconsin, sunny day in Michigan. And you see probably about the most divergent of pricing, you see one of the highest at \$2,600 a month—well over twice the cost for a car to be insured in Michigan, directly opposite the line of a car to be insured in Wisconsin.

And so, Mr. Lynch, could you comment on what Wisconsin is doing right in keeping these costs down?

Mr. LYNCH. Well, I wouldn't characterize personally, and in my position with a non-partisan organization, I wouldn't characterize it as right or wrong but I would characterize it. I can speak to the differences—

Mr. STEIL. What is causing that?

Mr. LYNCH. As I said, in Michigan you have no-fault automobile insurance with no limit to the policy. And if you have a \$10 million claim, that is a dollar on every person in the State of Michigan, give or take.

A comparable claim in Wisconsin would be, say, \$60,000, which is—how many people are there in Wisconsin? Sixty thousand divided by however many people there are that is what, like a dime

of policy and those things add up over time so I think that is probably the biggest driver.

I can tell you that to my knowledge, credit scoring is regulated in 40 States, it is banned in 2 or 3 but credit scoring is not the reason that rates are higher in Michigan or lower in Wisconsin, it is—

Mr. STEIL. It is interesting—

Mr. LYNCH. And I want to say one other thing—

Mr. STEIL. I am going to reclaim my time. I appreciate—

Mr. LYNCH. Sure.

Mr. STEIL. But we are so limited. I appreciate that take.

Mr. Chairman, I would like to insert in the record a letter from the American Property Casualty Insurance Association.

Chairman GREEN. Without objection, it is so ordered.

Mr. STEIL. And what it does is, it identifies and highlights some of these policy areas that we look at to ultimately drive down the cost of insurance and make it affordable for folks living both in Wisconsin and across the United States.

When we look at the importance of risk-based pricing and doing that—I want to just go across the panel, if I can and just ask, if you believe in risk-based pricing because it seems like on some of our discussion today maybe that is or maybe that is not the case and so just to go across.

Mr. Van Alst, do you believe in risk-based pricing on car insurance?

Mr. VAN ALST. For car insurance, yes.

Mr. STEIL. Ms. Cross?

Ms. CROSS. I defer to my fellow panelists, as I do not focus on insurance.

Mr. STEIL. All right.

Ms. Clarke?

Ms. CLARKE. Yes. But but the devil is in the details. And it—

Mr. STEIL. Okay. But risk-based pricing is—

Ms. CLARKE. Yes.

Mr. STEIL. Fair enough.

Mr. Rivera?

Mr. RIVERA. Risk-based pricing that doesn't discriminate on the basis of gender and other factors that are not proxies for income.

Mr. STEIL. Understood, the risk-based pricing at its core is an important aspect.

Mr. Lynch?

Mr. LYNCH. I would be consistent with the State laws in every State in the United States and say yes, risk-based pricing is an appropriate way to price automobile insurance.

Mr. STEIL. Thank you.

Going back to you, Mr. Lynch, as we look at insurance-based pricing, do you believe that non-driving related factors are predictive of driving risk?

Mr. LYNCH. Well clearly, they are, that is why they are used.

Mr. STEIL. And can you maybe describe for us the process that insurance companies are using to identify and evaluate these risks?

Mr. LYNCH. Well, when you price insurance, you use a two-step process and the first step is that you estimate what the average rate is going to be for the average consumer in wherever your book

of business is, let us say it is the State of Michigan. And then after that you go through a process and you identify through actuarial analysis of your data, supplemented by data from other companies sometimes that are outside of the insurance industry, and then that is how you determine based upon the risks that you find that correlates strongly with the likelihood of being in an accident and that is how you come up with rating factors to adjust your rate come to a final rate.

Mr. STEIL. Thank you very much.

I yield back my time.

Chairman GREEN. The gentleman's time has expired.

The gentleman from North Carolina, Mr. Budd, is recognized for 5 minutes.

Mr. BUDD. Thank you, Mr. Chairman, for letting me sit in on this hearing.

And I want to thank the witnesses as well.

It is not often that we have hearings about the insurance industry in the U.S. Congress, and that is because we have a State-based system that has been working well for over 150 years, so I believe that North Carolina insurers should answer to Raleigh and not to Washington, D.C., so again these are rare.

Mr. Lynch, I have reviewed the Insurance Research Council's April 2019 Report on Auto Insurance Affordability in Michigan and I would like to ask permission to enter this to the record, Mr. Chairman, if that is okay?

Chairman GREEN. Without objection, it is so ordered.

Mr. BUDD. Thank you, Mr. Chairman.

I want to make sure that I have the facts right. How many States, including Michigan, allow for the use of credit-scoring data in auto insurance underwriting, Mr. Lynch?

Mr. LYNCH. I believe that number is 47.

Mr. BUDD. Okay, 47. So it strikes me as fair to say that Michigan is not unique in allowing for the use of this predictive-scoring data, so how is Michigan unique?

Mr. LYNCH. As I said before, the no-fault automobile insurance system and the unlimited no-fault makes it different from every other State, the unlimited nature of it is itself unique.

Mr. BUDD. So this IRC Report states that the average cost of a claim for an auto accident in Detroit is \$51,000 on average per accident and the average cost of auto insurance coverage in the area is \$5,400 a year. Now, I have two teenage drivers in a home that I insure on one policy and it is less than that a year, in North Carolina, so how much of an outlier are these figures when compared with other States like North Carolina and what is to blame for the high cost of these figures?

Mr. LYNCH. Well, this is something that I think I have answered once or twice but it never hurts to try to make it a little clearer, when you have unlimited claims, when your claim can be any size especially in the United States where health insurance is so expensive, you can get claims where people suffer tremendous injuries, and in Michigan if it is in an automobile accident, not in any other kind of accident but if it is in an automobile accident, then the automobile insurance system as a whole has to bear that cost and

that cost ends up being directly reflected in the rates the consumers pay.

Mr. BUDD. So do you agree that State-based insurance legislators and regulators in Michigan can best solve this problem?

Mr. LYNCH. I work for an organization that doesn't make public policy recommendations and lobby so I can't really answer that. I can say that I have testified in the State of Michigan as they explore ways to alleviate this issue and that at the State level, they are very aware of it.

Mr. BUDD. Understood, and thank you, Mr. Lynch.

I agree, and I think we have identified the cost of sky-high auto insurance rates in Detroit and who can fix the problem. I see no reason for Congress to supersede, in my case North Carolina, in regulating my State's insurance market and I also see no reason why my constituents should be forced to subsidize Michigan or any other State for their seriously flawed State insurance laws.

With that, I sincerely want to thank Chairman Green for letting me join today's discussion.

And I yield back my time. Thank you.

Chairman GREEN. The gentleman yields back.

Without objection, the Chair now recognizes Ranking Member Barr for an additional 5 minutes.

Mr. BARR. Thank you once again, Mr. Chairman, for holding this hearing. And once again, I applaud you for your work in Congress and before Congress in combating invidious discrimination.

And as Members on both sides of the aisle have expressed today, race discrimination, any kind of discrimination has no place in our society, certainly not in auto lending, certainly not in insurance or any industry whatsoever.

I think what a lot of Members have expressed today and some of the witnesses as well is that we all want to get at discrimination, stop it, prevent it, but we also want to make sure that we don't eliminate risk-based pricing so that every good driver in America, and most people are good drivers, are not punished because they are not credited for their positive driving records, and I think it gets to this idea of socializing risk versus pricing insurance based on risk.

Let me ask Mr. Lynch one kind of final question to summarize what we have been discussing today and that is, would elimination of insurance credit-scores undermine the risk-based pricing model?

Mr. LYNCH. Well, to the degree that you restrict the ability to use proven predictors of accident rates, you are going to have a less robust model, it is going to get weaker and that would be regardless of the variable that you were deciding to restrict.

Mr. BARR. And let us really get at the core issue here, the core issue is that some of the witnesses on the panel are making the argument, as I perceive it, that credit scores are a proxy for race. Do you agree with that or not?

Mr. LYNCH. Well, no. They are not.

Mr. BARR. And tell me why you disagree with the other witnesses on that point?

Mr. LYNCH. Oh, well, when we look at insurance, we are told what is fair and you—what you have to do is create a fair rate and a fair rate is one, as I said in my remarks, that is neither too high

nor too low nor overcharges or undercharges a risk that presents themselves with a certain known risk characteristics, and all of that of course is silent as it should be to issues of race and income, so insurance companies do follow those laws and so that is kind of where I come to my conclusion.

Mr. BARR. If we eliminated credit scores completely from the underwriting of insurance, would an African American with a pristine driving record be subject to a higher premium?

Mr. LYNCH. I have no way to answer that question because the industry does not gather information based upon race so I can't say.

Mr. BARR. Well, forget the race, would drivers in general with good driving records, would they be subjected to higher premiums as a result of elimination of the use of credit scoring in underwriting premiums?

Mr. LYNCH. Well, most drivers have good driving records and the people who have good credit scores and good driving records and are presenting less risk to the insurance company would end up overpaying.

Mr. BARR. Okay. Without objection, Mr. Chairman, I would like to submit several items to the record.

The first is the Charles River Report on Fair Lending.

The second is a Report on Auto Insurance Affordability and Cost Drivers in Michigan.

The third is a letter to you and to me from the National Association of Mutual Insurance Companies, the Independent Insurance Agents and Brokers, the National Association of Professional Insurance Agents, and the American Property Casualty Insurance Association.

And the fourth is a statement by the National Association of Mutual Insurance Companies.

Chairman GREEN. Without objection, it is so ordered.

Mr. BARR. And with that, Mr. Chairman, I appreciate once again, your leadership in holding this hearing.

And I yield back.

Chairman GREEN. Thank you.

The Chair now yields 5 minutes to himself.

And I thank the Members, all of whom have said they are very much interested in making sure that we do not have invidious discrimination.

Let us talk for just a moment about the indirect auto lenders and how they work with the dealers, wherein the dealers are acting as agents to a certain extent of the lenders and once a price has been set for the purchase of a car with the indirect auto lender, the dealer has the option to mark up the interest rate and to do so without any rules or regulations for the most part and actually the dealer does it at his own discretion.

Do you agree that this is the case, Ms. Clarke?

Ms. CLARKE. That is indeed the case. It is a widespread practice.

Chairman GREEN. I have to move to the next person.

Ms. Cross, do you agree?

Ms. CROSS. Yes. I agree.

Chairman GREEN. And Mr. Van Alst?

Mr. VAN ALST. Yes.

Chairman GREEN. Okay. So we agree that the dealers can mark up within their discretion the final interest rate.

Now, let me ask this of you, Ms. Clarke. Between 2013 and 2016, the CFPB brought enforcement actions against four indirect auto lenders for violating the Equal Credit Opportunity Act by authorizing and incentivizing discretionary dealer interest rates. These markups resulted in non-white borrowers paying higher interest rates than non-Hispanic white borrowers. These actions garnered \$104 million in restitution for borrowers.

Under Director Mulvaney and Director Kraninger, however, the CFPB has not taken any public Fair Lending enforcement action against an indirect auto lender or any lender at all.

What are the consequences of the CFPB's lack of enforcement of Fair Lending Laws in the context of auto lending?

Let us start with you, Ms. Clarke, please. What are the consequences of the lack of enforcement?

Ms. CLARKE. We are implicitly sending a green light to dealers and lenders across the country that this kind of discriminatory lending practice is okay. And by rolling back—rescinding the 2013 CFPB Guidance we have seen lenders and dealers actually abandoned efforts and proactive steps that they were taking to reduce and eliminate the incentive for dealers to engage in those markups.

There are a lot of lenders who are imposing a flat rate which completely removed the incentive for dealers to markup loan interest rates so we are seeing the resurgence of discrimination as we see the Federal Government retreating from this space.

Chairman GREEN. What is a possible solution? And I will start with whomever would like to give me the first answer.

Mr. VAN ALST. I can think of two.

One, is to go ahead and prohibit this discretionary increase in the interest rate. There are many other methods that can be used to compensate dealers for the time or effort they spend trying to arrange financing, such as a flat rate.

Two, data collection, as we have discussed already today—without accurate and good data, we can't know what is going on. And currently, the Equal Credit Opportunity Act prohibits collection of race data in these transactions unlike the mortgage market. So it is very important that we gain that data to know what is happening.

Chairman GREEN. Would simply letting the buyer know that this markup exists be a beneficial disclosure?

Mr. VAN ALST. We have found that throughout the auto sale and finance process, disclosures can often be really ineffective. Dealers who do this on a regular basis are very good at getting consumers to sign things, disclosing things, while they are covering up with one hand or turning the consumers' attention elsewhere, simply disclosing this won't fix the problem and in fact as we pointed out already, consumers have to go through a long, arduous process to ever get to the point where they had have something like that disclosed and you can't do that.

Chairman GREEN. Let me move on to Ms. Cross. Ms. Cross, do you want to add something?

Ms. CROSS. Yes. One of the big things that you see happen is a lot of predatory tactics that disclosure won't necessarily fix 100 per-

cent. Yo-yo financing is an abusive tactic where a consumer is given the information about their loan and they think it is a final deal. And then later a lender can call back—days or weeks later, the dealership will call back and say, “Oh I am sorry, something went wrong with the financing. And we need to renegotiate and charge you a higher interest rate.”

Disclosure is a good principle in general, but it won’t necessarily cover all our bases in some of those predatory tactics we see.

Chairman GREEN. And Ms. Clarke, what would you recommend?

Ms. CLARKE. We need the CFPB and the DOJ to enforce the law. We need data collection to bring transparency to the practices of dealers and lenders. And finally, we need Congress to not abdicate its responsibility to eliminate racial discrimination, root, and branch across our country.

It is not enough for the States to do this work. They lack the unique expertise and resources that are embodied inside of our Federal Government agency. So we need strong Federal precedents, if we are going to ever combat the crisis that we are up against.

Chairman GREEN. Well, let me thank all of the witnesses for appearing today, and the Members as well.

The Chair notes that some Members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to these witnesses and to place their responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

And without objection, the hearing is adjourned.

[Whereupon, at 12:09 p.m., the hearing was adjourned.]

A P P E N D I X

May 1, 2019



STATEMENT OF KRISTEN CLARKE

PRESIDENT AND EXECUTIVE DIRECTOR

LAWYERS' COMMITTEE FOR CIVIL RIGHTS UNDER LAW

U.S. HOUSE COMMITTEE ON FINANCIAL SERVICES

SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS

**HEARING ON "EXAMINING DISCRIMINATION IN THE AUTOMOBILE LOAN AND
INSURANCE INDUSTRIES"**

MAY 1, 2019

Chairman Green, Ranking Member Barr, and Members of the Subcommittee, my name is Kristen Clarke, and I am the President and Executive Director of the Lawyers' Committee for Civil Rights Under Law ("Lawyers' Committee"). Thank you for the opportunity to testify today about discrimination in the automobile loan industry.

The Lawyers' Committee is a national civil rights organization created at the request of President John F. Kennedy in 1963. President Kennedy sought to enlist the private bar's leadership and resources in combatting discrimination and the resulting inequalities across America. For the past five decades, the Lawyers' Committee has been on the front lines of the fight for equality in the areas of economic justice, voting rights, fair housing, criminal justice, education, hate crimes, and more.

Unchecked Auto Lending Discrimination Contributes to the Growing Racial Wealth Gap

Almost 55 years after the passage of the federal Civil Rights Act of 1964, a stark racial wealth divide remains—a typical white family has \$140,500 in wealth, while a typical Black family has just \$3,400.¹ Evidence and data make clear that abusive, predatory automobile lending and lack of access to equitable financial services are factors that contribute to the wealth gap that we are witnessing today. Eliminating lending discrimination, root and branch, particularly across the automobile industry, stands as a core civil rights priority today.

Wealth provides families a safety net when faced with job insecurity, relocation, or emergency situations. Our country's long history of segregation and institutional racism has prevented families of color from accessing affordable credit and building generational wealth. Research has shown that lenders wrongly correlate race with risk, leading consumers of color to have a harder time getting credit for major life purchases. And when they do get credit, it is more expensive.² Lending discrimination, including in the auto finance market, contributes to the economic instability of families of color and the widening racial wealth gap.

Americans need reliable transportation to get to work, school, and other essential places. Communities of color that are deprived of economic investment often lack effective public transportation.³ Many who cannot rely on good public transportation systems need an affordable loan to get a car and to help them build good credit. In fact, most consumers need a loan to finance the purchase of a car.⁴

As the third-largest source of outstanding household debt after mortgages and student loans,⁵ car loans and their impact on communities of color warrant the close and immediate attention of Congress. African Americans and other consumers of color face discrimination in various ways when purchasing and financing a car. Studies have shown that buyers of color face significant bias in the auto market and are often charged higher car prices, higher interest rates, and more expensive insurance on the basis of their race or ethnicity. They are also targeted for predatory sales and repossession schemes.

A significant portion of car buyers receive financing through car dealers.⁶ Car dealers often sell financing contracts to indirect lenders, including banks or finance companies, for a fee. Indirect lenders compete for the financing contracts from the originating car dealers by allowing them to

increase their interest or “buy” rate with a discretionary profit-generating dealer markup. According to the Consumer Financial Protection Board (CFPB), “markups can generate compensation for dealers while giving them the discretion to charge consumers different rates regardless of consumer creditworthiness.”⁷ Many consumers are not aware that car dealers can tack on additional interest to their loan for the sole purpose of making a profit.

One of the most pernicious ways in which racial bias seeps into auto lending is through discretionary dealer markups. Indirect auto lenders often have no controls in place to prevent discretionary markup pricing disparities resulting from car dealers’ racial bias, resulting in people of color being burdened with more expensive car loans than white consumers.⁸ Widespread racial discrimination in indirect auto lending is not new and has been well documented over the past thirty years. In 1991, Professor Ian Ayres found that Black male consumers in Chicago were asked to pay more than two times the markup of white male consumers.⁹ In 2012, a similar study out of Vanderbilt University by Mark Cohen analyzed more than 1.5 million GMAC car loans between 1999 and 2003, and found that Black borrowers paid on average \$362 more than white borrowers in extra interest over the life of the car loan. Despite only representing 8.5 percent of all borrowers, Black borrowers paid nearly 20 percent of the \$422 million in subjective markups.¹⁰ And in 2015, the National Consumer Law Center released compelling data from indirect auto lending litigation spanning from the late 1990s to the early 2000s evidencing that African Americans were subjected to “statistically significant racial disparities” in “every state with sufficient data and in every region of the country.”¹¹

Federal Investigations and Enforcement Activity Must Play a Central Role in Combatting Ongoing Lending Discrimination Across the Automobile Industry

Under the prior Administration, the CFPB and the Department of Justice (DOJ) prioritized rooting out auto lending discrimination. Congress formed the CFPB as an independent agency under the Dodd-Frank Act in 2010 after the recession for precisely this reason—to protect vulnerable communities, including communities of color, from predatory financial practices, and to push the financial market towards equity. In 2013, the CFPB issued important guidance making clear that as creditors under the Equal Credit Opportunity Act (ECOA), indirect auto lenders may be liable for discrimination resulting from dealers’ discretionary markups. The guidance provided auto lenders with recommendations on how to ensure compliance with fair lending laws, including ECOA, that prohibit discrimination on the basis of race and other protected categories.¹²

In December 2012, DOJ and CFPB entered into an agreement to facilitate coordination on fair lending enforcement. Under the agreement, CFPB referred matters to DOJ when CFPB had reason to believe there was a pattern or practice of lending discrimination. CFPB and DOJ investigated and entered into substantial monetary agreements with some of the largest indirect auto lenders in the United States to resolve allegations that they had violated ECOA by charging borrowers of color higher dealer markups on the basis of their race and/or ethnicity.¹³ The various settlements entered into by the CFPB and DOJ, which recovered more than **\$140 million**

in restitution for thousands of borrowers of color, demonstrate the extent to which discrimination pervades auto lending practices.

In 2013, Ally Financial and Ally Bank entered into a settlement agreement for \$80 million in damages for borrowers of color and \$18 million in penalties, making it the largest auto loan discrimination settlement.¹⁴ More than 235,000 borrowers of color paid higher interest rates for car loans between April 2011 and December 2013.¹⁵ Data showed that 100,000 African Americans were charged approximately 29 basis points more in dealer markup than whites and were obligated to pay on average over \$300 more in interest than white borrowers over the life of the loan.¹⁶ 125,000 Hispanics were charged approximately 20 basis points more than whites, paying on average more than \$200 in additional interest over white borrowers.¹⁷ Similarly, 10,000 Asians were charged approximately 22 basis points more in dealer markup than whites and paid on average more than \$200 in additional interest.¹⁸ The settlement gave Ally the option to substantially reduce dealer markup discretion or to eliminate it all together.¹⁹ If, however, Ally allowed dealers to continue adding discretionary markups, then Ally had to provide education to dealers, conduct portfolio-wide analyses, and undertake prompt corrective action against dealers when racial disparities arose.²⁰

In July 2015, DOJ and CFPB entered into a settlement with Honda Finance for \$24 million in restitution for borrowers of color.²¹ Honda charged African-American borrowers 36 more points than whites in dealer markups, forcing African-American borrowers to pay \$250 more in interest over the life of the loan.²² Hispanic borrowers were charged 28 more points in dealer markups than whites and paid \$200 more in interest.²³ Asians were charged 25 points more in dealer markups than whites and paid \$150 more in interest.²⁴ CFPB and DOJ found that Honda was not monitoring whether discrimination was occurring across its portfolio of retail installment contracts, which were allowed to charge markups, and they did not employ adequate controls to prevent discrimination.²⁵ The settlement gave Honda the option to substantially reduce discretion or to eliminate it all together.²⁶

In September 2015, CFPB and DOJ entered into an \$18 million settlement with Fifth Third Bank.²⁷ In this case, Fifth Third Bank charged African-American and Hispanic borrowers, on average, \$200 more for their car loans.²⁸ Fifth Third Bank was also required to either substantially reduce the amount by which loans could be marked up or to eliminate discretion altogether.²⁹

Most recently, in February 2016, CFPB and DOJ entered into a settlement with Toyota Motor Credit.³⁰ The settlement required that Toyota create a \$21.9 million restitution fund for African American and Asian borrowers.³¹ Toyota charged African-American borrowers, on average, over \$200 more for their car loans and charged Asian borrowers, on average, over \$100 more in interest.³² Toyota was required to either substantially reduce the amount by which loans can be marked up or eliminate discretion altogether.³³

In each of the indirect lending investigations, the retail installment contracts analyzed by CFPB and DOJ did not contain information on the race or national origin of borrowers. To evaluate

differences in dealer markup, the CFPB and DOJ assigned race and national origin probabilities to applicants. CFPB and DOJ employed a proxy methodology that combined geography-based and name-based probabilities, based on public data published by Census Bureau, to form a joint probability using the Bayesian Improved Surname Geocoding (“BISG”) method. The joint race and national origin probabilities obtained through BISG was then used directly in the CFPB’s and DOJ’s models to estimate disparities in dealer markup on the basis of race or national origin.³⁴

In addition to its actions against indirect lenders, DOJ partnered with the North Carolina Attorney General to reach a deal with two North Carolina “buy here, pay here” used car dealerships that intentionally targeted African-American customers for unfair and predatory credit and repossession practices.³⁵ Reverse redlining is the practice of intentionally targeting African Americans for the extension and servicing of credit on unfair and predatory terms without meaningfully assessing the customers’ creditworthiness.³⁶ The suit alleged that two “buy here pay here” used car dealerships in Charlotte, North Carolina, had sales prices, down payments, and interest rates that were disproportionately high compared to other subprime used car dealers.³⁷ The suit further alleged that the dealerships were not engaging in a meaningful assessment of the consumers’ creditworthiness or ability to repay, causing their default and repossession rates to be disproportionately high.³⁸ There were also claims that the dealerships engaged in predatory repossession tactics when customers were not even in default.³⁹ The dealers agreed to reform their practices and to pay \$225,000 in restitution to the impacted consumers.

This administration, however, has turned a blind eye to auto lending discrimination even though continuing research shows that it is an ongoing problem. A 2018 study by the National Fair Housing Alliance using matched pair testers in Virginia showed that almost 63 percent of the time, borrowers of color received costlier auto loans even though they were *more* qualified than their white counterparts and that the borrowers of color would have paid an average of \$2,351 more over the life of the loan as a result of the discrimination.⁴⁰

Under the Trump administration, DOJ has retreated from fair lending enforcement against auto lenders. The CFPB has also stopped bringing enforcement actions against auto lenders engaging in discriminatory practices. In addition to defanging the enforcement authority of the Office of Fair Lending and Opportunity,⁴¹ the administration rescinded the 2013 CFPB guidance encouraging indirect auto lenders to proactively comply with ECOA.⁴² Not surprisingly, several lenders who had previously implemented flat fee models in response to the CFPB’s guidance have reverted back to discretionary dealer rate programs.⁴³

Congress Must Reject Impending Attacks on Disparate Impact Liability

Since the beginning of the Trump administration, the CFPB has made clear its goal to attack the cognoscibility of disparate impact claims as one method of proving an ECOA violation. For example, during his tenure as the Director of the CFPB, Mick Mulvaney released a statement maintaining that the CFPB would be reexamining the requirements of the ECOA, including disparate impact.⁴⁴ Since she has replaced Mulvaney, Director Kathleen Kraninger has stated to

the Senate Banking Committee that the CFPB is currently studying whether disparate impact should be used to prove discrimination.⁴⁵ This move would be devastating for those who seek to hold lenders accountable, taking away one of the CFPB's most powerful enforcement tools for ensuring fair lending. Therefore, Congress must take this opportunity to make clear that it intends to protect disparate impact liability as a way to root out discrimination.

Congressional Response to Modern Day Auto Lending Discrimination

This administration's lack of enforcement will continue to result in auto lenders prioritizing profit over equality and nondiscrimination. Therefore, we ask Congress to enact robust legislation to increase protections for borrowers of color in the auto lending market. Legislative proposals considered by Congress should either prohibit or significantly limit discretionary dealer markups. To the extent dealer markups are allowed, auto dealers and lenders must be required to disclose important credit terms, including dealer markups, to borrowers earlier in the car buying process, not after the credit transaction is finalized, as currently required by the Truth in Lending Act.

Furthermore, Congress should use its extensive oversight authority over the Justice Department's Civil Rights Division and CFPB to understand the significant downturn in their enforcement activity in this area. The U.S. Justice Department has significant resources and unique expertise in this area. The retreat of our federal government has led to the resurgence of discriminatory and predatory lending practices, as evidenced by lenders who are reverting back to discretionary pricing schemes. Such a lack of enforcement allows discriminatory practices to continue without recourse, deepening the harm to African Americans, Latinos, and other borrowers of color, and weakening civil rights laws.

Congress should also consider action that would require auto lenders to report borrower demographic information, including race and ethnicity, in connection with its loans to facilitate fair lending analysis and enforcement. The Home Mortgage Disclosure Act (HMDA), which requires mortgage lenders to collect, report, and publicly disclose borrower demographic data, provides a model to guide reform. HMDA requires nearly all mortgage lenders to report detailed information on the mortgage applications they receive, and whether they originate the loan.⁴⁶ HMDA is enforced by the Office of the Comptroller of the Currency ("OCC") and administrative sanctions, including civil money penalties, may be imposed by the OCC for noncompliance.⁴⁷ Only very small lenders, or those operating exclusively in rural areas, are exempt from HMDA reporting.⁴⁸ HMDA data include each applicant's requested loan size, income, race, and ethnicity, as well as information on the purpose of the loan (purchase, refinancing, improvement), any co-applicants, and the loan's priority (first or second lien).⁴⁹ The census tract location of the property is also reported.⁵⁰ Because of its robust collection, HMDA data facilitates the straightforward identification of discriminatory patterns and practices by lenders engaged in conduct that unquestionably harms consumers along lines of race.

Borrowers of color deserve to participate in the marketplace free from discrimination. Yet, they face extensive hurdles in gaining fair and equal access to auto lending credit which further

threatens economic mobility and progress. In the absence of the CFPB and DOJ undertaking enforcement action to protect African Americans and other borrowers of color from discrimination in auto lending, we urge legislators to prioritize this issue by enacting legislation that will hold auto lenders accountable and further strengthen existing protections under ECOA.

Conclusion

Discriminatory auto lending poses grave financial danger to African American, Latino and other vulnerable consumers. Increasingly, lenders are taking advantage of a highly unregulated and unmonitored market to promote discriminatory and predatory practices. We thank this committee for sounding an alarm about this aspect of the auto loan market and for undertaking careful fact-finding to identify appropriate remedial responses. We urge Congress to fully leverage its investigative, oversight and law-making powers to safeguard the rights of our nation's most vulnerable consumers, to hold predatory auto lenders accountable and to ensure that our federal agencies are carrying out their role and responsibility in enforcing the law.

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¹Emanuel Nieves and Dedrick Asante-Muhammad, *Running in Place: Why the Racial Wealth Divide Keeps Black and Latino Families from Achieving Economic Security* (Washington, DC: Prosperity Now, 2018), 5.

² Angela Hanks, Danyelle Solomon and Christian E. Weller, *Systemic Inequality: How America's Structural Racism Helped Create the Black-White Wealth Gap*, Center for American Progress (Feb. 21, 2018),

<https://www.americanprogress.org/issues/race/reports/2018/02/21/447051/systematic-inequality/> (Last Accessed April 29, 2019).

³ Lisa Rice and Erich Schwartz, Jr., *Discrimination When Buying a Car: How the Color of Your Skin Can Affect Your Car-Shopping Experience* (Washington, DC: National Fair Housing Alliance, 2018), 9.

⁴ *Id.*, 6.

⁵ *Id.*

⁶ *Id.*

⁷ See generally CFPB press releases announcing agreements with Ally Financial Inc., Honda Finance Corporation, Toyota Motor Credit, and Fifth Third Bank. Available at www.cfpb.gov.

⁸ *Id.*

⁹ See Jason Hernandez, *Loan Discrimination At the Auto Dealership: Current Cases, Strategies and the Case For Intervention By Attorneys General*, Columbia University, <https://web.law.columbia.edu/sites/default/files/microsites/career-services/Loan%20Discrimination%20At%20The%20Auto%20Dealership.pdf>.

¹⁰ *Id.*

¹¹ “Racial Disparities in Auto Loan Markups State-by-State Data,” National Consumer Law Center, June 2015.

¹² Indirect Auto Lending and Compliance with ECOA, CFPB Bulletin 2013-02, Mar. 21, 2013 available at https://files.consumerfinance.gov/f/201303_cfpb_march_-_Auto-Finance-Bulletin.pdf.

¹³ *Supra* note 7. Ally Financial, Honda Finance, Toyota Motor Credit and Fifth Third Bank agreed to limit the amount of their dealer markups and collectively paid over \$140 million in restitution for thousands of borrowers of color.

¹⁴ Consumer Fin. Prot. Bureau, *CFPB and DOJ Order Ally to Pay \$80 Million to Consumers Harmed by Discriminatory Auto Loan Pricing*, (Dec. 20, 2013) <https://www.consumerfinance.gov/about-us/newsroom/cfpb-and-doj-order-ally-to-pay-80-million-to-consumers-harmed-by-discriminatory-auto-loan-pricing/> (Last Accessed April 29, 2019).

¹⁵ *Id.*

¹⁶ *Id.*

¹⁷ *Id.*

¹⁸ *Id.*

¹⁹ *Id.*

²⁰ *Id.*

²¹ Consumer Fin. Prot. Bureau, *CFPB and DOJ Reach Resolution with Honda to Address Discriminatory Auto Loan Pricing*, (Jul. 14, 2015), <https://www.consumerfinance.gov/about-us/newsroom/cfpb-and-doj-reach-resolution-with-honda-to-address-discriminatory-auto-loan-pricing/> (Last Accessed April 29, 2019). See Also Dept. of Justice, *Justice Department and Consumer Financial Protection Bureau Reach Groundbreaking Settlement to Resolve Allegations of Auto Lending Discrimination by Honda*, (Jul. 14, 2015), <https://www.justice.gov/opa/pr/justice-department-and-consumer-financial-protection-bureau-reach-groundbreaking-settlement> (Last Accessed April 29, 2019).

²² *Id.*

²³ *Id.*

²⁴ *Id.*

²⁵ *Id.*

²⁶ *Id.*

²⁷ Consumer Fin. Prot. Bureau, *CFPB Takes Action Against Fifth Third Bank for Auto-Lending Discrimination and Illegal Credit Card Practices*, (Sept. 28, 2015) <https://www.consumerfinance.gov/about-us/newsroom/cfpb-takes-action-against-fifth-third-bank-for-auto-lending-discrimination-and-illegal-credit-card-practices/> (Last Accessed April 29, 2019).

²⁸ *Id.*

²⁹ *Id.*

³⁰ Consumer Fin. Prot. Bureau, *CFPB and DOJ Reach Resolution With Toyota Motor Credit To Address Loan Pricing Policies With Discriminatory Effects*, (Feb. 2, 2016) <https://www.consumerfinance.gov/about-us/newsroom/cfpb-and-doj-reach-resolution-with-toyota-motor-credit-to-address-loan-pricing-policies-with-discriminatory-effects/> (Last Accessed April 29, 2019).

³¹ *Id.*

³² *Id.*

³³ *Id.*

³⁴ See, e.g., https://files.consumerfinance.gov/f/201602_cfpb_consent-order-toyota-motor-credit-corporation.pdf.

³⁵ Dept. of Justice, *U.S. Justice Department and North Carolina Attorney General Reach Settlement to Resolve Allegations of Auto Lending Discrimination by "Buy Here, Pay Here" Used-Car Dealerships*, (Feb. 10, 2015), <https://www.justice.gov/opa/pr/us-justice-department-and-north-carolina-attorney-general-reach-settlement-resolve> (Last Accessed April 29, 2019).

³⁶ *Id.*

³⁷ *Id.*

³⁸ *Id.*

³⁹ *Id.*

⁴⁰ *Supra* note 3, at 5.

⁴¹ Makada Henry-Nickie, *On Fair Lending, Mulvaney's Actions at CFPB Speak Louder than His Words*, (Washington, DC: Brookings Institution, 2018). Available at <https://www.brookings.edu/research/on-fair-lending-mulvaney-actions-at-cfpb-speak-louder-than-his-words/>.

⁴² Zachary Warmbrodt, "Trump signs bill blocking consumer bureau auto-lending measure," May 21, 2018. Available at <https://www.politico.com/story/2018/05/21/trump-signs-bill-blocking-cfpb-auto-lending-measure-558281>.

⁴³ Hannah Lutz, "As CFPB Retreats, What's Next for Dealer Reserve?," (Feb. 19, 2018) discussing that BB&T and BMO Harris Bank, two major auto lenders have done away with flat fee structures. Available at https://www.autonews.com/article/20180219/FINANCE_AND_INSURANCE/180219770/as-cfpb-retreats-what-s-next-for-dealer-reserve.

⁴⁴ Evan Weinberger, "CFPB to Review Use of Disparate Impact in Fair Lending Cases," BLOOMBERG BNA (May 21, 2018), <https://www.bna.com/cfpb-review-disparate-n57982092803/#!>.

⁴⁵ Evan Weinberger, "CFPB Chief Hedges on Potential Fair Lending Enforcement Pullback," BLOOMBERG LAW (Mar. 12, 2019), <https://news.bloomberglaw.com/banking-law/cfpb-chief-hedges-on-potential-fair-lending-enforcement-pullback-1>.

⁴⁶ Alexander W. Butler, Erik J. Mayer, and James P. Weston, *Discrimination in the Auto Loan Market* (Feb. 6, 2019).

⁴⁷ Consumer Compliance Examination, *Home Mortgage Disclosure Comptroller's Handbook* (Feb. 2010), <https://www.occ.gov/publications/publications-by-type/comptrollers-handbook/home-mortgage-disclosure/pub-ch-home-mortgage-disclosure.pdf>.

⁴⁸ Alexander W. Butler, Erik J. Mayer, and James P. Weston, *Discrimination in the Auto Loan Market* (Feb. 6, 2019).

⁴⁹ *Id.*

⁵⁰ *Id.*

Testimony of R.J. Cross

Policy Analyst, Frontier Group

Testifying on Behalf of Frontier Group and U.S. Public Interest
Research Group

At A Hearing On

**Examining Discrimination in the Automobile
Loan and Insurance Industries**

**Before the U.S. House of Representatives
Committee on Financial Services, Subcommittee
on Oversight and Investigations**

The Honorable Al Green, Chairman

1 May 2019

Thank you for the opportunity to appear before you today to discuss the state of U.S. auto lending. I am a policy analyst at Frontier Group, a non-profit public policy think tank and am also testifying today on behalf of the U.S. Public Interest Research Group, with whom we co-authored our recent report, *Driving Into Debt*. Our report examined how auto lending has changed since the Great Recession, and how those changes have ultimately put consumers at risk.

SCOPE OF PROBLEM

In much of the country, owning a car is a virtual necessity. It is how you get to work, to the grocery store, and to the doctor. A car, in short, is the price of admission to leading a full, productive life. Owning a car is also expensive. Transportation is the second-leading expenditure for American households, behind only housing.¹ Approximately one hour of the average American's working day is spent earning the money needed to pay for the transportation that enables them to get to work in the first place.² These expenses of car ownership drive millions of households to take on debt.

Currently, Americans owe more for their cars than they ever have before. The total amount of outstanding auto debt is over \$1.2 trillion. Since the end of 2009, the amount Americans owe on their cars has increased 75 percent (51 percent when adjusted for inflation).³

But it is not only that overall auto debt has reached historic levels – the number of Americans who owe for their cars is also at its highest in U.S. history with over 113 million open loan accounts, a jump of nearly 40 percent from 2010 to 2018. In mid-1999, there were approximately 18 auto loan accounts open for every 100 Americans. By mid-2017, that figure had nearly doubled, to 34 accounts per 100 Americans.⁴

And consumers are at risk. Delinquencies are rising. The percentage of auto debt that is seriously delinquent – meaning 90 days late or more – is the highest it has been since 2012 and is still climbing. More than 7 million Americans have missed at least three monthly car payments.⁵

¹ U.S. Bureau of Labor Statistics, *Consumer Expenditures – 2017* (press release), 11 September 2018, archived at <https://web.archive.org/web/20190111151547/https://www.bls.gov/news.release/pdf/cesan.pdf>.

² Based on U.S. Bureau of Labor Statistics, *Consumer Expenditure Survey, 2017*, accessed at <https://www.bls.gov/cex/2017/combined/age.pdf>. Mean household transportation expenses were \$9,576, in 2017, and mean household income was \$73,573. Transportation expenses were equivalent to 13 percent of income, representing approximately one hour of an eight-hour working day. (Transportation expenditures also include spending not specifically related to work travel.)

³ Federal Reserve Bank of New York, Center for Microeconomic Data, *Household Debt and Credit Report (Q3 2018)*, November 2018, data downloaded 5 December 2018 from <https://www.newyorkfed.org/microeconomics/hhdc.html>.

⁴ Ibid.

⁵ Gabrielle Coppola, “Auto-Loan Delinquencies Are the Highest Since 2012,” *Bloomberg*, 12 February 2019.

These numbers are concerning on their own. What makes them deeply troubling is that they are happening in a strong U.S. economy. Compared with the size of the U.S. economy, outstanding auto debt is larger now than at any time other than the period between the 2001 and 2007 recessions, at 5.5 percent of gross domestic product.⁶

Something important has been happening in the auto credit market. Since the Recession, the lending practices that have boosted auto sales have also put the financial well-being of millions of American households at risk.

HOW WE GOT HERE

In the aftermath of the 2008 financial crash, investors and lenders alike noticed that auto debt performed relatively well during the Recession.⁷ This - coupled with the federal government's bailout of the auto industry and key lenders - sparked interest across the board in bringing more borrowers into the auto credit market and onto showroom floors.⁸ Lenders of all types took steps to do so.

First, lenders loosened standards for prospective borrowers. Immediately following the federal bailout of the auto industry, GMAC publicly stated it would use its bailout funding to offer credit to consumers, lowering the minimum credit score to qualify for financing from 700 down to 621.⁹ Other lenders followed suit.

We found in our report that auto debt has risen across all income levels, but it's risen the fastest among those with the lowest incomes. Since 2009, according to data from the Consumer Financial Protection Bureau, borrowing by residents of low-income neighborhoods has increased nearly twice as quickly as borrowing by residents of high-income neighborhoods.¹⁰

⁶ Percentage of GDP calculated based on outstanding auto loan balances from Board of Governors of the Federal Reserve System, *Consumer Credit – G.19*, data downloaded from <https://www.federalreserve.gov/datadownload/Build.aspx?rel=g19>, 21 December 2018; and nominal GDP from Federal Reserve Bank of St. Louis, *Gross Domestic Product, Billions of Dollars, Quarterly, Seasonally Adjusted Annual Rate*, data downloaded from <https://fred.stlouisfed.org>, 21 December 2018. Note: the Federal Reserve Board reports lower outstanding auto loan balances than the Federal Reserve Bank of New York, whose data are used in most of this report, due to differing underlying data sources. (The New York Fed data are based on credit reports, while the Federal Reserve data are based on reports from lenders.)

⁷ Ben McLannahan, "Debt Pile-up in U.S. Car Market Sparks Subprime Fear," *The Financial Times*, 29 May 2017.

⁸ Associated Press, "Chrysler Financial Gets \$1.5B Loan from Bailout," *NBCNews.com*, 16 January 2009, archived at <https://web.archive.org/web/20190113193907/http://www.nbcnews.com/id/28694293/ns/business-autos/t/chrysler-financialgets-b-loan-bailout/>.

⁹ Bree Fowler, "GMAC Says It's Using \$5 Billion from Rescue Plan to Loosen Credit on Auto Loans," *Associated Press*, 31 December 2008.

¹⁰ Consumer Financial Protection Bureau, *Lending by Neighborhood Income Level* (CSV file), accessed at <https://www.consumerfinance.gov/data-research/consumercredit-trends/auto-loans/lending-neighborhoodincome-level/>, 21 December 2018.

Lending in the subprime market followed a similar trajectory. During the Recession, subprime lending fell steeply. In 2007, subprime and deep subprime loans accounted for 23 percent of all U.S. auto debt outstanding, a figure that fell to 14 percent by the end of 2009.¹¹ The surge in subprime lending during the economic recovery caused that figure to bounce back quickly. By 2016, lending to subprime and deep subprime borrowers made up as much as 26 percent of all auto loans originated that year.¹²

In addition to benefiting from low interest rates, lenders used other tools to bring additional borrowers into the marketplace, including lengthening the terms of auto loans.

Extending loan terms brings down the monthly payment. In the era of Netflix and other monthly subscription-based services, the monthly payment is an important measure by which many consumers determine affordability. Low-income borrowers are particularly sensitive to changes in loan maturity according to a 2007 study, suggesting that the longer loan terms of recent years may have been an important spur for the rapid rise in auto loans to low-income households.¹³

While longer loan terms may reduce the monthly payment amount, they also mean that the consumer will pay more over the life of the loan in interest payments, and will spend more time “underwater” on a car – or owing more for the car than it is worth.

Whereas a 48-month loan used to be the industry standard, loans of five or more years have become increasingly commonplace. In 2009, new auto loans with a term of six years or more accounted for 26 percent of all loans originated. By 2017, it was up to 42 percent.¹⁴

Consumers with a six-year long loan are twice as likely to default as those with a five-year loan.¹⁵ Borrowers with these longer-term loans are also more likely to have a poorer credit history. An analysis by the Consumer Financial Protection Bureau found that the average credit score of a borrower taking out a six-year auto loan is 39 points below that of a borrower with a five-year term auto loan.¹⁶

¹¹ Consumer Financial Protection Bureau, *Borrower Risk Profiles* (CSV file), accessed at <https://www.consumerfinance.gov/data-research/consumer-credit-trends/auto-loans/borrower-riskprofiles/>, October 2017.

¹² Jessica Silver-Greenberg and Michael Corkery, “The Car Was Repossessed, But the Debt Remains,” *New York Times*, 18 June 2017.

¹³ Orazio P. Attanasio, Pinelopi K. Goldberg and Ekaterini Kyriazidou, *Credit Constraints in the Market for Consumer Durables: Evidence from Micro Data on Car Loans*, March 2007.

¹⁴ Kenneth P. Brevoort, et al., Consumer Financial Protection Bureau, *Quarterly Consumer Trends: Growth in Longer-Term Auto Loans*, November 2017, accessed at http://files.consumerfinance.gov/f/documents/cfpb_consumer-credit-trends_longerterm-auto-loans_2017Q2.pdf.

¹⁵ Ibid.

¹⁶ Ibid.

This period also saw the rise of more outright abusive and predatory tactics in one part of the auto credit market: dealer financing.

INDIRECT LENDING

A direct loan, or a loan a consumer gets directly from a traditional financial institution like a bank or credit union, is the safest avenue for consumers. There are clear laws, regulations and oversight over this kind of transaction.

Indirect lending is when a consumer finances through a dealership, with the exception of Buy-Here Pay-Here lots which provide in-house financing. In dealer-arranged financing, the dealer is a creditor in this arrangement, selling the loan to another financial institution, and often having the consumer sign a retail installment sales contract. Dealer-arranged financing creates incentives that often work to the detriment of consumers, and it is governed by rules that are often less protective of consumers' interests.

ABUSE

One major area of abuse is excessive interest rates. Dealers have the ability to mark up the interest rates they receive from the lenders to whom they sell their finance contracts, pocketing the difference as profit.¹⁷

Having consumers sign a retail installment sales contract not only allows a dealer to charge a higher interest rate, these rates can sometimes exceed state usury limits. In one example, a package of securities Santander Consumer Holdings Inc., one of the largest U.S. auto lending firms, was selling to investors was found to have 57 percent of included loans from the state of New York carrying interest rates that would have been illegally high if it had been the bank making the loan to consumers directly. Because those contracts were indirect loans, those interest rates were legal.¹⁸

There's also been evidence of lenders failing to verify the income of borrowers. For example, in 2017, Santander Bank was found by Moody's to have verified the income of borrowers on only 8 percent of auto loans it then bundled into \$1 billion worth of bonds and sold to investors.¹⁹ At dealerships, there have been instances of car salespersons raising the reported income of a consumer when shopping around a loan in order to ensure the consumer qualifies for financing,

¹⁷ Christopher Kukla, "The Hidden Cost of Car Loans," *U.S. News & World Report*, 27 February 2014.

¹⁸ Ryan Felton, "The Devastating Loophole that Sticks Car Buyers with Interest Rates that Would Otherwise Be Illegal," *Jalopnik*, 29 March 2018, archived at <https://web.archive.org/web/20181004211628/https://jalopnik.com/thedevastating-loophole-that-sticks-car-buyers-within-1823885194>.

¹⁹ Matt Scully, "Auto Lender Santander Checked Income on Just Eight Percent in Subprime ABS," *Bloomberg*, 22 May 2017, accessed at <https://www.bloomberg.com/news/articles/2017-05-22/subprime-auto-giant-checked-income-on-just-8-of-loans-in-abs>.

even if they ultimately can't afford to repay the loan.²⁰ In key respects, auto lending in the last decade has been a "Groundhog Day"-like repeat of many of the same practices that contributed to the mortgage crisis.

Dealer-arranged financing has also enabled discriminatory pricing. Since its creation, the Consumer Financial Protection Bureau has investigated a number of large captive finance groups that work with dealers to provide indirect financing for charging borrowers of color higher interest rates than similarly situated white borrowers. This includes some of the largest indirect lending firms in the nation, like Toyota Motor Credit, whose policies led to many African-American borrowers paying \$200 more on average for financing.²¹ These CFPB investigations have repeatedly found that lenders giving dealers the ability and incentive to mark up interest rates enables this kind of discrimination.

In 2018, however, Congress passed and President Trump signed legislation revoking the CFPB guidance on indirect auto lending that had provided notice to lenders that actions like those against Toyota Motor Credit and other lenders such as Ally, American Honda Finance and Fifth Third Bank may occur. This congressional action, while it does not alter the CFPB's statutory authority to address discrimination in auto lending, may make it more likely that discriminatory auto lending practices will go unchallenged.

These are only a few examples of the ways dealer financing threatens the financial well-being of Americans. There are add-on products dealers can make to sound mandatory, and yo-yo financing practices that force consumers to renegotiate after they were told the deal was done.²² The entire list of threats consumers – and particularly the most vulnerable amongst us – face is appalling. That so little action has been taken to stop these predatory behaviors is even more so.

CONCLUSION

Americans currently owe more for our cars than we have at any point in history. More of us are making monthly car payments and we're paying them off for longer. Delinquencies are rising even though the economy is strong, and it's in large part due to lending practices designed to get more people into a new car as soon as possible, including abusive and deceptive tactics that target borrowers with the most to lose. I think we can all agree that American consumers deserve better.

²⁰ Federal Trade Commission, *FTC Charges Auto Dealerships in Arizona and New Mexico with Falsifying Consumers' Information on Financing Documents* (news release), 1 August 2018.

²¹ Consumer Financial Protection Bureau, *CFPB and DOJ Reach Resolution with Toyota Motor Credit to Address Loan Pricing Policies with Discriminatory Effects* (news release), 2 February 2016, accessed at <https://www.consumerfinance.gov/about-us/newsroom/cfpb-and-doj-reach-resolution-with-toyota-motor-credit-to-address-loan-pricing-policies-with-discriminatory-effects/>.

²² Delvin Davis, Center for Responsible Lending, *Auto Loans: The State of Lending in America & its Impact on U.S. Households*, December 2012.



RATING AUTOMOBILE INSURANCE

Testimony before U.S. House of Representatives Financial Services
Committee/Subcommittee on Oversight & Investigations

May 1, 2019



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First, I would like to take a moment to thank Rep. Green and the entire committee for giving me the opportunity to speak today.

My name is James Lynch. I am chief actuary and senior vice president of research and education at the Insurance Information Institute in New York. Founded in 1960, we are the trusted source of unique, data-driven insights to inform and empower consumers. We want people to have the information they need to make educated decisions, manage risk, and appreciate the essential value of insurance. Our membership includes eight of the 10 largest personal auto insurance writers in the United States. Unlike other sources, our sole focus is disseminating information; we neither lobby nor sell insurance. We provide objective, fact-based information about insurance – information that is rooted in economic and actuarial soundness.

I am a Fellow of the Casualty Actuarial Society, the leading property/casualty actuarial organization in the world, and I serve on the society's board of directors. I have more than a quarter-century of experience in property/casualty insurance and reinsurance and have held senior actuarial positions at QBE the Americas and White Mountains Reinsurance of America.

Today I would like to discuss how companies set rates for automobile insurance.

Because of court cases and federal legislation that stretch back decades, insurance companies are primarily regulated at the state level. Every insurance company must satisfy the laws and regulations of every state it operates in, plus the District of Columbia. So most large insurers, have 51 sets of laws to follow and 51 sets of regulators to satisfy.

Every state regulates what insurers can charge for personal auto insurance.

State laws ensure that rates:

- Aren't too high, because no state wants its consumers overcharged.
- Aren't too low, because if rates are too low, an insurance company might lack the funds to pay all the claims it has said it will pay.
- Are lower for drivers who are less likely to be in a crash and higher for drivers who are more likely to be in a crash.

The company can only offer a discount if it can show that the customer is less likely than the average customer to suffer an insured loss. It can only surcharge if it can show the customer is more likely than the average customer to suffer a loss.

Insurers can't change rates daily or weekly, the way a grocery store can change the price of a gallon of milk. They must notify the state, usually beforehand, what they intend to charge. In some states the Department of Insurance must explicitly approve changes in advance.

The result: Auto insurance is not priced according to the law of supply and demand. It is a cost-plus product. Insurers estimate what they will pay out in claims, then add in expenses and a reasonable profit (which generally works out to be less than what the average Fortune 500 company earns).

In addition to state regulators, auto insurers operate in an extremely competitive environment, and an important part of that competition is to develop the most perfect set of rates possible. Insurance companies develop sophisticated plans that consider the likelihood of being in a crash.

A company with an inferior rating plan quite accidentally charges some customers too much and some too little. None of the people they overcharge will stay with them long – there are better deals to be had. All the customers they undercharge will stay indefinitely, because they are getting a great deal. Unfortunately for the insurance company, it will lose money until it fixes its problem.

Insurers use teams of actuaries to figure out how to set rates – how much to charge the average risk; who deserves a discount; and who does not. They look for characteristics that successfully predict the accident rate. The most famous, perhaps, is driving record. Drivers who have avoided accidents for several years are less likely to be in an accident in the future. But driving record is not the only rating factor. The strongest by most accounts is location, which tells a lot about the number of vehicles per square mile. The more cars there are in an area, the more likely they are to crash into each other.

There are certain things it is important to know about rating variables:

- First: They work. They are effective at gauging the likelihood that a customer will be in an accident.
- Second: They are selected after rigorous actuarial analysis. Every rating variable has been proved effective through analysis of actual data.
- Third: They are filed in advance with state regulators, along with statistical proof of their effectiveness. In some states, they must be approved in advance. And they can't be changed without going through the same regulatory process. Any federal effort to oversee rating variables will overlap rigorous efforts that states already undertake.

- Fourth: Companies constantly review how effective these factors are. If they don't work in the real world, they are adjusted or abandoned.
- Fifth: Factors can change over time, and actuaries adjust those factors as a result. For example, gender is a well-known, commonly used variable, and part of the reason it has been effective is that men drive more miles than women. That is changing. From 1963 to 2013, the number of miles the average man drove increased by about a third, but the number of miles the average woman drove increased nearly 90 percent. (Sivan, 2015) The predictive power of gender as a rating variable has changed because the more miles you drive, the more likely you are to be in a crash, and women are approaching men in that respect.

- Sixth: The variables interact with each other, often in subtle ways.

Actuaries incorporate the interaction into rates.

Interaction is a bit difficult to describe, though I think you will recognize it from this example in the world of health. Smoking increases the chance of throat cancer. Drinking does as well. However, a person who smokes and drinks has a greater chance of throat cancer than you would expect if you just added together the effect from each behavior. They interact. Each behavior strengthens the effect of the other, like two evil bullies, egging each other on.

Actuaries have gotten better at analyzing this in recent years, thanks to better data and faster computers. This increasing sophistication also means that a simple one-way analysis – changing, say, the gender of a

hypothetical driver while holding all other information constant – does not give a complete picture of how insurers treat that rating variable. There may be interactions between gender and one of the variables held constant, and that information is lost in this sort of simplistic analysis.

- Seventh: Insurers are constantly looking for new variables. When they find one, the new one can change how much emphasis is placed on the old ones.
- Last but certainly not least: The setting of private-passenger auto insurance rates is a color-blind process. U.S. auto insurers do not gather information based on race or income, nor do they discriminate against anyone on the basis of race or income. U.S. auto insurers do not adjust their rates based on any proxy for race or income.

Thank you for your time. I would be happy to respond to any questions you might have.

U.S House Subcommittee on Oversight and Investigations
Committee on Financial Services
“Examining Discrimination in the Automobile Loan and Insurance Industries”
May 1, 2019

Statement of Joshua Rivera
Data and Policy Advisor, Poverty Solutions at the University of Michigan

Chairman Green, Ranking Member Barr, and distinguished members of the Committee, thank you for the invitation to participate in today’s hearing. I appreciate the opportunity to discuss auto insurance affordability and the disproportionate impact of certain rate-setting practices on low-income and minority drivers.

Our team at Poverty Solutions first got the idea to research auto insurance directly from Detroit residents, as we analyzed the barriers to economic mobility in a city where 34.5 percent of residents live in poverty.¹ In conversations with local stakeholders, time and time again they flagged the exorbitant price of auto insurance as a major barrier to reducing poverty, one that certainly was not on our minds when we started. Workforce providers told us that high auto insurance rates prevent residents from driving to job opportunities. Nonprofits told us they worried about the financial burden auto rates place on the fragile budgets of working-class families. When Detroit Mayor Mike Duggan was asked by *The Economist* what keeps him up at night, it was perhaps of no surprise to Detroiters that he said, “car insurance”.²

When we started to look at the data, what we found stunned us. Michigan has the most expensive automobile insurance in the United States, with an estimated annual premium in 2018 of \$2,610, almost double the national average.³ This burden, however, does not fall equally. With an average annual premium of \$5,414, Detroiters face the most expensive car insurance rates in the country. To put this in context, the typical Detroit household has an income of \$30,000 a year, which means car insurance will eat up 18 percent of their annual pre-tax income.

The sticker-shock prompted us to research how the state got here in the first place and why it was the case that low-income and minority communities, like Detroit, face the greatest burden.

The resulting policy brief, “Auto Insurance and Economic Mobility in Michigan: A Cycle of Poverty” documents the problems and offers potential solutions for auto insurance reform in Michigan. I have included a copy of the policy brief with my written testimony for the record.

What we learned locally has important implications for potential federal action on auto insurance. Michigan is not alone in grappling with the issue of affordability. Nor is Michigan alone in considering whether rate-setting practices lead low-income drivers to pay much more than others with similar driving records for auto insurance.

¹ U.S. Census Bureau, 2017 American Community Survey 1-Year Estimates

² “Why Detroit Is the Most Expensive City in America to Buy Car Insurance.” *The Economist*, The Economist Newspaper, 5 July 2018, www.economist.com/united-states/2018/07/05/why-detroit-is-the-most-expensive-city-in-america-to-buy-car-insurance.

³ Cooney, Patrick, Elizabeth Phillips, and Joshua Rivera. *Auto Insurance and Economic Mobility in Michigan: A Cycle of Poverty*. Report. Poverty Solutions, University of Michigan.

Auto insurance rates are rising across the country. In 2018, 184 million U.S drivers—nearly four out of five—faced a rate increase.⁴ This continues a trend in recent years where average car insurance prices have risen at more than double the rate of inflation.⁵ Along with Michigan, drivers in Louisiana, Rhode Island, and Florida also face annual average premiums above \$2,000. Only in four states - Maine, Virginia, North Carolina, and Iowa – is the average auto insurance rate below \$1,000. State averages, though, can mask huge differences in what drivers pay. Estimated annual premiums are \$2,814 in New York City, \$2,913 in Miami, and \$3,686 in New Orleans.

Rising auto insurance prices present a growing affordability challenge. The U.S. Treasury Department's Federal Insurance Office deems auto insurance "unaffordable" in areas where premiums exceed 2 percent of a ZIP code's median household income.⁶ In 2017, the FIO found that nearly 19 million people live in ZIP Codes where auto insurance is unaffordable.

We applied this standard to recent data from The Zebra, a premiere auto insurance comparison marketplace, and found that auto insurance rates represent more than 2 percent of median household income in 97 percent of Michigan's ZIP codes. Even in relatively higher-income cities, like Royal Oak and Farmington Hills, rates are above this threshold of affordability ranging from 2 to 4 percent of pre-tax income.

Yet, the burden is strikingly greater for lower-income and minority communities. In places like Saginaw, rates eat up to 12 percent of area income, and in Flint, between 8 and 24 percent of residents' pretax income. By comparison, the Department of Housing and Urban Development considers someone spending more than 30 percent of their income on rent to be cost burdened.

We also found that rural communities are especially hit hard by high rates. These communities deal with particularly poor roads and have to drive longer distances for employment, which makes affordable transportation matter that much more.⁷

These costs make it harder for people to move up the economic ladder, especially for low-income families locked out of the auto insurance market by the lack of affordable coverage options.

Take the case of a family where the household head is above the age of 65 and relies on Social Security as the primary source of income. In 2018, the maximum monthly Social Security benefit was \$2,788 a month. It would take nearly two months' worth of Social Security benefits to cover the annual cost of auto insurance in Detroit.

⁴ "The State of Auto Insurance 2019" The Zebra. 2019. Accessed April 26, 2019. <https://www.thezebra.com/state-of-insurance/auto/2019/>.

⁵ Kunkle, Fredrick. "Auto Insurance Rates Have Skyrocketed - and in Ways That Are Wildly Unfair." The Washington Post. February 07, 2018. Accessed April 26, 2019. <https://www.washingtonpost.com>

⁶ US Treasury Federal Insurance Office. (2017, January). Study on the Affordability of Personal Automobile Insurance. Retrieved from <https://www.treasury.gov>

⁷ Evans, Maxwell, and Maxwell Evans. "Auto Insurance Premiums Also Burdensome in Rural Michigan." Sault Ste. Marie Evening News - Sault Ste. Marie, MI. February 20, 2019. Accessed April 26, 2019. <https://www.soeveningnews.com/news/20190220/auto-insurance-premiums-also-burdensome-in-rural-michigan>.

Now imagine a family of four with incomes at the federal poverty level (\$25,750). An affordable auto insurance policy for that family would cost \$515. That is \$2,095 less than the average premiums in Michigan. For working poor households in high cost communities across the country, affording auto insurance coverage is nearly impossible.

A lack of affordable auto insurance options stifles economic opportunity in three major ways. First, the high price of insurance makes legal car ownership extremely challenging for low-income families, preventing individuals from getting to the places they need to go to pursue opportunity.

Second, it is a huge drain on low-income families' scarce resources. Every dollar spent on auto insurance is a dollar that is not spent on higher education, healthy food, quality housing and other investments that promote a higher quality of life.

Finally, uninsured drivers are placed at significant financial and legal risk. It is estimated that 20 percent of Michigan drivers and 60 percent of Detroit drivers do not purchase insurance.⁸ Motorists caught driving without insurance risk misdemeanor charges, fines, and potential jail time, which could set an individual back — perhaps permanently — in their pursuit to climb out of poverty.

Why are rates so high? There are many factors at play, from broader economic trends, to rising healthcare costs, and differences in state regulatory practices.

Yet one factor for why rates vary so considerably between drivers is that insurance companies use non-driving characteristics to set premiums for customers. This includes factors such as gender, educational attainment, home ownership status, and insurance scores derived from credit scores.

The use of non-driving characteristics in rate setting means a consumer could pay more if they lose their spouse, they could pay more if they faced a financial emergency and are behind on their bills, and they could pay more for living in a rural community.

It is reasonable to ask whether the use of non-driving factors in setting premiums is unfair and whether there is potential for discrimination in rate setting.

Of these factors, credit scores are by far the biggest cost driver for consumers, with rates more than doubling for those with poor versus excellent credit.⁹ This is a big problem, particularly for Detroit residents, who collectively have some of the lowest credit scores in the country.¹⁰ Thus, a working single mother in Detroit with a perfect driving record but bad credit could be charged one of the highest auto insurance premiums of any person in the entire country, despite never having been cited for a traffic violation, made a claim or been part of a traffic accident.

⁸ Waterman, C. (2015, April 03). Driving without insurance? Police in Michigan can now tell just by running your plate. Retrieved from https://www.mlive.com/news/bay-city/index.ssf/2015/03/driving_without_insurance_poli.html

⁹ "The Secret Score behind Your Rates." How a Credit Score Affects Your Car Insurance - Consumer Reports. 2015. Accessed April 26, 2019. <http://www.consumerreports.org>

¹⁰ Diulio, Nick. "Study: Poor Credit Can Double Auto Insurance Rates." Insurance Quotes. Accessed April 26, 2019. <http://www.insurancequotes.com>

Several studies in recent years provide suggestive evidence of disparities in auto insurance premiums. In 2007, a study in Los Angeles found that auto insurance rates were higher in low-income and minority neighborhoods, even after accounting for common risk factors cited by insurance companies in setting premiums.¹¹ A decade later, ProPublica issued a report on auto insurance prices, which found that drivers in predominantly minority ZIP codes were being charged higher rates, as compared to similar risky drivers in predominantly white areas.¹²

In 2017, the Consumer Federation found that, all else being equal, women over the age of 25 pay more for auto insurance than men.¹³ In addition, just this year, the Zebra issued a report showing that on average women now pay more than men in 25 states.¹⁴ Efforts to reduce auto insurance rates need to address disparities in pricing in order to achieve meaningful improvements in affordability.

What can be done? While numerous policy levers to reduce auto rates are typically within the purview of the states, Congress has expressed interest in curtailing rate-setting practices at the federal level.

In our report, we called on Michigan to curb the use of non-driving factors in setting rates, following the model of several other states that already do this.

Prohibiting the use of all factors unrelated to a consumer's driving record may not be feasible: insurance companies must be able to develop actuarially sound models. But other states have struck compromises. California, for example, has established reasonable rate-setting guidelines, where insurance companies are required to prioritize three factors: driving record, annual miles driven, and years of driving experience. After these have been taken into account, several other (optional) factors may be added, such as frequency of claims, age, and address. However together these cannot carry more weight than the first three.¹⁵ The use of credit score is not permitted. In this model, how you drive in the most important thing, you can prove yourself on the road. Based on a study by the Consumer Federation of America, low-income drivers in U.S. cities pay 59 percent more for auto insurance than those with higher incomes. In Los Angeles, this gap is just 9 percent, likely due to these regulations.¹⁶

¹¹ Ong, Paul M., and Michael A. Stoll. "Redlining or Risk? A Spatial Analysis of Auto Insurance Rates in Los Angeles." *Journal of Policy Analysis and Management* 26, no. 4 (September 07, 2007). <https://doi.org/10.1002/pam.20287>.

¹² Larson, Jeff, Julia Angwin, Lauren Kirchner, Surya Mattu, Dina Haner, Michael Saccucci, Keith Newsom-Stewart, Andrew Cohen, and Martin Romm. "How We Examined Racial Discrimination in Auto Insurance Prices." ProPublica. March 09, 2019. Accessed April 26, 2019. <https://www.propublica.org/article/minority-neighborhoods-higher-car-insurance-premiums-methodology>.

¹³ "What? Women Pay More Than Men for Auto Insurance? (Yup)." The Pew Charitable Trusts. Accessed April 26, 2019. <https://www.pewtrusts.org/en/research-and-analysis/blogs/stateline/2019/02/11/what-women-pay-more-than-men-for-auto-insurance>.

¹⁴ "Study: Women Now Pay More Than Men for Car Insurance in 25 States | The Zebra." Study: Women Now Pay More Than Men for Car Insurance in 25 States | The Zebra. Accessed April 26, 2019. <https://www.thezebra.com/research/men-women-auto-insurance-differences-by-state/>.

¹⁵ Breitenbach, Sarah. "Some States Take Aim at 'Discriminatory' Auto Insurance Pricing." The Pew Charitable Trusts. Accessed April 26, 2019. <http://www.pewtrusts.org/en/research-and-analysis/blogs/stateline/2015/08/28/some-states-take-aim-at-discriminatory-auto-insurance-pricing>.

¹⁶ If you're poor, you'll pay more for car insurance, study finds. Retrieved from <http://www.startribune.com/report-low-income-drivers-pay-59-percent-more-for-car-insurance/384565011/>

In Hawaii, where the use of credit scores has been banned since 1987, the Commissioner of Insurance testified before Congress in 2007 that despite the ban, markets remained competitive and healthy.¹⁷

In closing, with sensible reforms to our auto-insurance policies, we can lower transportation costs and dramatically improve economic opportunity for families. Thank you, again, for inviting me to share my research findings with you. I would be happy to answer any questions.

¹⁷ *Credit-based Insurance Scores: Are they Fair?*(2007) (testimony of Schmidt, Hon. J.P., Commissioner of Insurance, State of Hawaii).



AUTO INSURANCE AND ECONOMIC MOBILITY IN MICHIGAN: A CYCLE OF POVERTY

MARCH 2019

By Patrick Cooney, Elizabeth Phillips, and Joshua Rivera

Michigan has the most expensive automobile insurance in the United States, with an estimated annual premium of \$2,610, almost double the national average.¹ This burden, however, does not fall equally. With an average annual premium of \$5,414, Detroiters face the most expensive car insurance rates in the country,² and other low-income Michigan communities are subject to extreme rates as well. In turn, a large proportion of Michigan residents drive uninsured, leaving themselves and others open to financial risk, especially in lower-income communities.³ Altogether, this means that the cost of auto insurance has become a major barrier to mobility from poverty in Detroit and across the state.

This brief discusses the link between economic mobility and transportation, and examines the disproportionate impact of extreme car insurance prices on low-income Michiganders. It explores why coverage is so expensive here, and offers two goals for reform: 1) to reduce the cost of auto insurance across the state, and 2) to narrow the gap between what Michigan's wealthiest and poorest residents pay. Both goals are critical for the state to end a cycle of poverty that puts Michigan as a whole, and particularly low-income residents, at a competitive disadvantage.

TRANSPORTATION AND ECONOMIC MOBILITY

Transportation is vitally important to economic mobility.⁴ Whether to get to a new job, go back to school, or make it to a doctor's appointment, reliable and affordable transportation can make the difference in moving up the economic ladder. In Detroit, public transportation is under-resourced,⁵ and many entry-level job opportunities are located in the surrounding suburbs,⁶ which are largely inaccessible by public transportation. Thus, reliable access to transportation in Detroit often means reliable access to a car.

Yet, the price of auto insurance creates a huge barrier to automobile ownership in Michigan, and in Detroit in particular. The U.S. Treasury Department's Federal Insurance Office deems auto insurance "unaffordable" in areas where premiums exceed 2 percent of a ZIP code's median household income.⁷ This standard can be applied to recent data from The Zebra, a premiere auto insurance comparison marketplace. The Zebra collects rate information from public rate filings and insurance rating platforms. In total, the data provides an average rate per ZIP code for a "base profile" insured driver.⁸ This exercise yields car insurance rates that represent more than 2 percent of median household income in 97 percent of all Michigan ZIP

¹ The State of Auto Insurance 2019 | The Zebra. [2018]. Retrieved from <http://www.thezebra.com/state-of-insurance/auto/2018/>

² Livengood, C. [2017, October 22]. How Michigan's auto insurance premiums became the highest in the country. Retrieved from <http://www.craigslist.com/articles/20171022/news/442726/how-michigans-auto-insurance-premiums-became-the-highest-in-the-country>; Coffey, M. [2017, September 28]. What's Wrong with Michigan's No-Fault Automobile Insurance. Retrieved from <https://www.mackinac.org/archives/2017/09/28/07.pdf>

³ U.S. Treasury Federal Insurance Office. [2017, January]. Study on the Affordability of Personal Automobile Insurance. Retrieved from https://www.treasury.gov/initiatives/fio/reports-and-notices/Documents/FINAL_AutoAffordabilityStudy_web.pdf

⁴ Bouchard, M. [2015, May 07]. Transportation Emerges as Crucial to Escaping Poverty. Retrieved from <https://www.nytimes.com/2015/05/07/upshot/transportation-emerges-as-crucial-to-escaping-poverty.html>

⁵ Kiertzner, J. [2018, January 18]. Amazon cut Detroit over regional transportation. Retrieved from <https://www.wxyz.com/news/region/detroit/detroit-leaders-told-by-amazon-regional-transportation-is-why-we-didnt-make-the-cut>

⁶ Coxen, T., Falby, J., La Prad, J., MacFarlane, T., & Sherard-Freeman, N. [2016]. DETROIT'S UNTAPPED TALENT: JOBS AND ON-RAMPS NEEDED. Retrieved from <http://skilledwork.org/wp-content/uploads/2016/01/CSW-Detroit-Mapping-FINAL-APPROVED.pdf>

⁷ U.S. Treasury Federal Insurance Office. [2017, January]. Study on the Affordability of Personal Automobile Insurance. Retrieved from https://www.treasury.gov/initiatives/fio/reports-and-notices/Documents/FINAL_AutoAffordabilityStudy_web.pdf

⁸ The Zebra's method involves using a base profile for an insured driver to collect information on rates. According to the Zebra, that profile is, "...a 30-year-old single male driving a 2013 Honda Accord EX with a good driving history and coverage limits of \$50,000 bodily injury liability per person/\$100,000 bodily injury liability per accident/\$50,000 property damage liability per accident with a \$500 deductible for comprehensive and collision".

codes. In Detroit, average rates represent between 12 and 36 percent of residents' pre-tax income in nearly every ZIP code. By comparison, the Department of Housing and Urban Development considers housing costs to be unaffordable if they surpass 30 percent of income.

As shown in Figure 1, the vast majority of Michigan communities are also above the 2 percent affordability threshold, yet the burden is substantially greater for low-income communities:

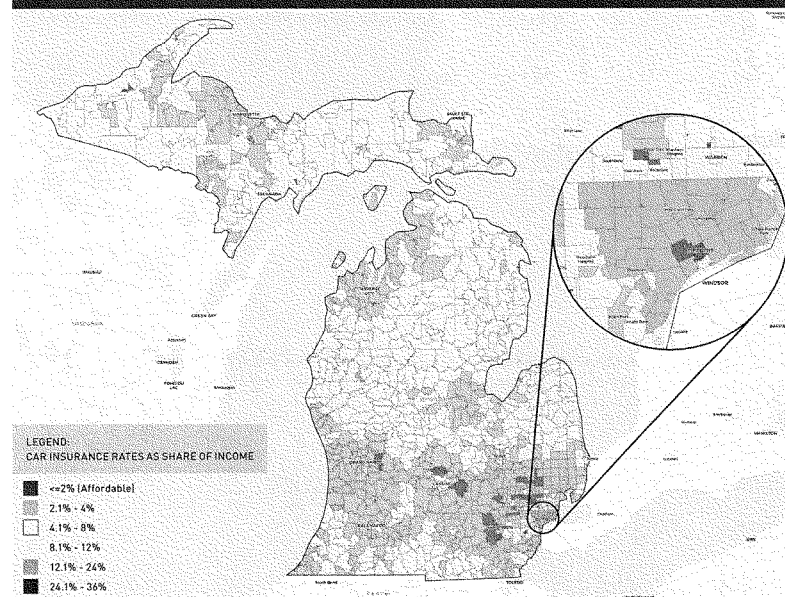
- Royal Oak, Farmington Hills, and Livonia face rates above the affordability threshold, but these range from 2.1 to 4 percent of area median household income.

- In Pontiac and Flint, in contrast, rates vary between 8 and 24 percent of median income.
- Saginaw and Ypsilanti's rates are 4 to 12 percent of the area's median household income.

The only affordable ZIP Codes in Michigan are in more affluent communities:

- In Southeast Michigan, Dexter, Birmingham, Bloomfield Hills, and parts of Ann Arbor face affordable rates, in part, due to higher household incomes in those area.
- Williamston and DeWitt, two cities outside of Lansing, meet the affordability threshold.

FIGURE 1: CAR INSURANCE AS PERCENT OF PRE-TAX INCOME BY ZIP CODE



Another lens by which to view affordability is to compare the cost of auto insurance in Detroit to what is experienced in other cities. As shown in Table 1, for the typical Detroit household making \$30,344 a year, car insurance can eat up 18 percent of annual income. For the 34.5 percent of Detroiters at or below the poverty level, the picture is even starker. A family of four with an income right at the poverty level (\$24,600 in 2017) would pay an estimated 22 percent of their total annual income toward car insurance. In contrast, car insurance accounts for between just 2 to 4 percent of pre-tax income in peer cities⁹ such as Cleveland, St. Louis, and Chicago, as well as higher income cities such as Seattle and Boston.

Unaffordable insurance may force low- and moderate-income individuals to forgo driving, limiting their ability to get to school, health care appointments, or jobs that are often outside the city limits. Recent findings from a representative survey of Detroiters finds that 34 percent don't own a car, and nearly a quarter report having recently missed work or an appointment due to lack of transportation.¹⁰

Others may respond to extreme insurance rates by driving uninsured, for instance thinking that getting to a job merits the risk. Nationally, an estimated 13 percent of drivers are uninsured. In Michigan, the corresponding rate is 20 percent, 4th highest in the country. In Detroit, the estimate is closer to 60 percent, more than four times higher than the national average.¹¹ Those caught driving without insurance risk a misdemeanor charge punishable by up to one year in jail and a fine of \$200-\$500.¹² Even further, until recently Michigan had strict "driver responsibility fees," through which 317,000 Michiganders and 70,000 Detroiters had their driver's licenses suspended, often as result of driving uninsured.

WHY IS AUTO INSURANCE SO EXPENSIVE IN MICHIGAN?

Michigan's particular mix of insurance policies, together with lax regulations, combine to drive up the cost of auto insurance for Michiganders, with low-income residents hit the hardest. The most frequently cited reason for Michigan's high rates is the

TABLE 1: AVERAGE ANNUAL PREMIUMS AS A PERCENT OF MEDIAN HOUSEHOLD INCOME

PLACE	AVERAGE CAR INSURANCE PREMIUM	MEDIAN HOUSEHOLD INCOME	CAR INSURANCE AS PERCENT OF PRE-TAX INCOME
Detroit	\$5,414	\$30,344	18%
Cleveland	\$1,277	\$28,974	4%
Dallas	\$2,123	\$50,427	4%
St. Louis	\$1,390	\$41,441	3%
Pittsburgh	\$1,440	\$45,851	3%
Atlanta	\$1,616	\$57,597	3%
Chicago	\$1,472	\$55,295	3%
Minneapolis	\$1,613	\$40,789	3%
National	\$1,427	\$60,336	2%
Boston	\$1,497	\$66,758	2%
Seattle	\$1,345	\$66,822	2%

Source: The Zebra, the State of Auto Insurance 2018; U.S. Census Bureau, 2017 American Community Survey 1-Year Estimates

state's unique form of no-fault insurance, with unlimited Personal Injury Protection (PIP).¹³ Michigan is one of 12 states with a no-fault insurance system, whereby a driver's own insurance company pays for damages from an accident, no matter who is at fault. Importantly, though, Michigan is the only state that requires drivers to purchase unlimited PIP coverage (Table 2). This means that in the event of an accident, automobile insurers are on the hook for unlimited medical damages, which drives up the costs of insurance for everyone. While the cost of these benefits only made up 6 percent of premiums in 1972, they currently account for 42 percent of average premiums.¹⁴

⁹ Peer cities selected for comparison are borrowed from the Detroit Regional Chamber's list of national peer cities used in the State of the Region 2018-2019 report; Detroit Regional Chamber. (2018). State of the Region 2018-2019. Retrieved from www.detroitchamber.com

¹⁰ Detroit Metro area Communities Study (2017) Detroit's Views on Transportation and Mobility. Retrieved from <https://poverty.umich.edu/files/2018/05/W2-Transportation-F.pdf>

¹¹ Insurance Information Institute [n.d.]. Facts Statistics: Uninsured motorists. Retrieved from <https://www.ii.org/fact-statistic/facts-statistics-uninsured-motorists>; Reindl, J. (2017, May 08). How aggressive lawyers, costly lawsuits and runaway medical bills make Detroit car insurance unaffordable. Retrieved from <http://www.freep.com/story/news/local/michigan/detroit/2017/05/08/no-fault-auto-insurance-detroit-michigan/100326640/>

¹² Waterman, C. (2015, April 03). Driving without insurance? Police in Michigan can now tell just by running your plate. Retrieved from https://www.mlive.com/news/livay-city/index.ssf/2015/03/driving_without_insurance_poli.html

¹³ Ibid.; Heaton, P. (2010, January 01). Auto Insurance Reform in Michigan: What Can the Data Tell Us? Retrieved from http://www.rand.org/pubs/occasional_papers/QP293.html

¹⁴ Oosting, J. (2019, February 14). Duggan to lawmakers: Michigan auto insurance system "morally indefensible". Retrieved from <https://www.detroitnews.com/story/news/local/michigan/2019/02/13/duggan-lawmakers-michigan-auto-insurance-law-morally-indefensible/2858343002/>

In addition, Michigan does not impose medical fee schedules,¹⁵ meaning that hospitals can charge auto insurers more than they can charge health insurers. This leads no-fault insurers in Michigan to be charged significantly more than Medicare, Workers Comp, or private insurers for the exact same medical procedures.¹⁶

Together, this means that the average cost per claim is dramatically higher in Michigan than in other states. In 2013, the

average cost per auto accident claim in Michigan was over \$75,000—more than *five times the figure in the next highest state*. New Jersey, also a no-fault state, was the next highest with an average cost of \$13,600.¹⁷ As one might expect, with unlimited protection and no regulations on medical fees, the system is a prime target for personal injury attorneys, with PIP-related first-party lawsuits now making up two thirds of all lawsuits in the state.¹⁸ Large settlements resulting from these suits contribute to Michigan's high auto insurance rates.¹⁹

TABLE 2: MINIMUM CAR INSURANCE COVERAGE REQUIREMENTS IN NO-FAULT STATES²⁰

STATE	PERSONAL INJURY PROTECTION (PIP)	PROPERTY DAMAGE (PD)	BODILY INJURY (BI)	UNINSURED MOTORIST (UM)	FRAUD AUTHORITY?	MEDICAL FEE SCHEDULE?	PROHIBITED RATING FACTORS?	AVERAGE PREMIUM
MI	Unlimited, Lifetime	\$10K	\$20K/40K	Optional	Yes	No	No	\$2,410
FL	\$10K	\$10K	Optional	Optional	Yes	Yes	No	\$1,878
NY	\$50K	\$10K	\$25K/\$50K	\$25K/\$50K	Yes	Yes	Yes	\$1,582
HI	\$10K	\$10K	\$20K/40K	Optional	Yes	Yes	Yes	\$1,079
KS	\$4,500/person	\$25K	\$25K/\$50K	\$25K/\$50K	Yes	No	No	\$1,427
KY	\$10K*	\$25K	\$25K/\$50K	Optional	Yes	Yes	No	\$2,050
MA	\$8K/	\$5K	\$20K/40K	\$20K/\$40K	Yes	No	Yes	\$1,201
MN	\$40K/	\$10K	\$30K/60K	\$25K/\$50K	Yes	No	Yes	\$1,258
NJ	\$15K, \$250K	\$5K	\$15K/30K	Optional	Yes	Yes	No	\$1,679
PA	\$5K*	\$5K	\$15K/30K	Optional	Yes	Yes	No	\$1,433
UT	\$3K	\$15K	\$25K/5K	Optional	Yes	Yes	No	\$1,112
ND	\$30K	\$25K	\$25K/\$50K	\$25K/\$50K	Yes	No	No	\$1,230

* In addition, the Zebra report notes the following. "Kansas requires \$4,500 each for medical and rehabilitation. "Kentucky and Pennsylvania are "no-fault choice" states, where drivers can opt for full-tort car insurance. "New Jersey's \$250,000 medical minimum applies only to specific serious injuries. PIP "Add-on" States: Arkansas, Delaware, Washington D.C., Maryland, Oregon, South Dakota, Texas, Wisconsin, South Carolina, Washington".

Source: reprinted from Why Michigan Is in the Middle of a Car Insurance Crisis—and What Can Be Done by The Zebra retrieved from www.thezebra.com

¹⁵ Insurance Information Institute, February 3, 2014. "Background on: No-fault auto insurance"

¹⁶ Mosley, R. C., Jr. (2015, June 8). D-Insurance: City of Detroit Insurance Company Feasibility Study. Retrieved from www.detroitmi.gov

¹⁷ Ibid.

¹⁸ Reindl, J. (2017, May 07). No-fault car insurance in Michigan: Here's how it works. Retrieved from <https://www.freep.com/story/news/local/michigan/detroit/2017/05/06/no-fault-car-insurance-michigan-heres-how-it-works/100668453/>; Reindl, J. (2017, May 08). How Michigan got - and kept - no-fault auto insurance. Retrieved from <https://www.freep.com/story/news/local/michigan/2017/05/06/michigan-no-fault-insurance-history-detroit/100501828/>; Reindl, J. (2017, May 07). Detroit car insurance: 6 other factors behind the cost of auto insurance. Retrieved from <https://www.freep.com/story/news/local/michigan/2017/05/06/detroit-car-insurance-cost/100792660/>

¹⁹ Casazza, C. (2017, July 07). Is It Time to Do Away with No-Fault Laws? Retrieved from <http://www.forbes.com/sites/ccasazza/2017/07/07/is-it-time-to-do-away-with-no-fault-laws/#5d8d13dbb66>

²⁰ Why Michigan Is in the Middle of a Car Insurance Crisis - and What Can Be Done. (2018, October). Retrieved from <https://www.thezebra.com/research/michigan-car-insurance-crisis/#unlimited-medical-coverage>

WHY ARE RATES SO HIGH IN DETROIT?

As started earlier, the average price of an auto policy in Detroit is \$5,414, eating up 18 percent of the median household income of Detroiters.²¹ One reason Detroit rates are higher as compared with the rest of the state is the volume and size of PIP claims in the city. These high levels of PIP claims are driven in part by the relative lack of private health insurance in Detroit. No-fault benefits are tapped before Medicare or Medicaid by law, so PIP benefits are called upon more frequently in places where public insurance coverage is more common, and private coverage is less so. This means that PIP is more likely to be called on to address damages than in other parts of the state. Not only are there far more PIP claims in Detroit than in the surrounding suburbs, but PIP claims are for almost double the amount (\$59,000 on average, compared to \$30,000).²² This then drives up insurance premiums in the city.

Another reason for Detroit's highest-in-the-nation rates is that insurance companies use non-driving characteristics to set premiums for customers.

This includes factors such as marital status, educational attainment, home ownership status, and credit scores. Because these factors are not directly related to one's driving record—yet are highly correlated with income—critics have argued that their use in setting premiums amounts to insurance “redlining”, with the same policy costing thousands of dollars more in the city limits of Detroit than it does just a few miles outside it. Of these factors, credit scores are by far the biggest cost driver, with rates more than doubling for those with poor versus excellent credit.²³ This is a big problem for Detroit residents, who collectively have some of the lowest credit scores in the country.²⁴ Thus, a single mother in Detroit with a perfect driving record but bad credit could be charged one of the highest auto insurance premiums of any person in the entire country, despite never having been cited for a traffic violation or having been a part of a traffic accident.

WHAT CAN WE DO?

Addressing the extreme costs of auto insurance—and removing a major barrier to mobility from poverty for low-income residents in Detroit and across the state—will require compromise, sacrifice, and collective action by numerous stakeholders. Hundreds of bills have been introduced in the State Legislature over the past ten to fifteen years to address the issue, but so far, little agreement has been reached. Some proposals focus on redlining, targeting the way in which insurers use non-driving factors in setting premiums. These proposals would reduce the extent to which premiums vary within the state, but would not necessarily lower premiums across the state. Others focus on reining in PIP payouts, and in doing so reducing premiums statewide, but perhaps leaving in place significant geographical variation. In order to control rates and achieve buy-in from all stakeholders, both factors must be addressed.

REINING IN PIP PAYOUTS

A clear way to reduce rates would be to rein in PIP payouts. This could be done by:

- **REPLACING MANDATORY UNLIMITED LIFETIME PIP COVERAGE WITH A BROADER MENU OF COVERAGE OPTIONS.** Michigan is the only state in the U.S. that requires drivers to purchase unlimited PIP coverage.²⁵ ²⁶ Doing away with mandatory unlimited lifetime coverage—and allowing consumers to select the coverage that best fits their needs as is done in other insurance markets—is the clearest way to reduce rates across the state, including in Detroit. Doing so is critical to reducing costs, but is likely to face significant opposition from interest groups that would be hurt financially by this change.
- **IMPOSE FEE SCHEDULES.** Michigan does not use fee schedules for medical care, creating numerous perverse incentives for stakeholders in the system. Several recent bills have included proposals to variously cap PIP fees at

21 Ibid.

22 Ibid.

23 THE SECRET SCORE BEHIND YOUR RATES. In d.l. Retrieved from <http://www.consumerreports.org/cro/car-insurance/credit-scores-affect-auto-insurance-rates/index.htm#creditmap>; Study: Poor Credit Can Double Auto Insurance Rates. In d.l. Retrieved from <http://www.insurancequotes.com/auto/study-how-poor-credit-doubles-auto-insurance-rates-82218>.

24 Dudley, D. (2016, October 17). Detroit Is America's Capital of Bad Credit. Retrieved from <https://www.citylab.com/life/2016/10/detroit-is-americas-capital-of-bad-credit/504137/>; Ludwig, S. (2015, October 13). Credit scores in America perpetuate racial injustice. Here's how | Sarah Ludwig. Retrieved from <https://www.theguardian.com/commentisfree/2015/oct/13/your-credit-score-is-racist-heres-why>; Darity, W., Jr., Hamilton, D., Paul, M., Aja, A., Price, A., Moore, A., & Chiopris, C. (2018). What We Get Wrong About Closing the Racial Wealth Gap. Retrieved from socialpolicy.wisc.edu

25 Reindl, J. (2017, May 09). No-fault fixes? How other states reined in auto insurance costs. Retrieved from <http://www.freep.com/story/news/local/michigan/2017/05/08/how-can-auto-insurance-detroit-affordable/100918492/>

26 Other no-fault states have mandatory minimum PIP purchase requirements ranging from \$3,000 in Utah to \$50,000 in New York.

anywhere from 100% to 160% of the Medicare rate (130% is the standard Michigan uses for Workers Compensation).²⁷ Doing so would immediately reduce costs associated with the system.

- **LIMIT CLAIM TIME.** Under current law, accident victims in Michigan can initiate treatment during a one-year window. Reducing this window (as other states have done) could reduce fraud and the number of lawsuits associated with PIP claims.

REFORM RATE SETTING PRACTICES

A few states explicitly restrict the use of credit scores or other non-driving factors in setting rates. Their use is commonly raised as a concern by consumer advocates and residents of low-income neighborhoods who argue that racism and redlining contribute to unreasonably high rates that are not justified by the cost of insuring.

Prohibiting the use of all factors unrelated to a purchaser's driving record is difficult; insurance companies must be able to develop actuarially sound models. But other states have struck compromises on this. California, for example, has established reasonable rate-setting guidelines, where insurance companies are required to prioritize three factors: driving record, annual miles driven, and years of driving experience. After these have been taken into account, several other (optional) factors may be added, such as marital status, frequency of claims, age, and address. However together these cannot

carry more weight than the first three.²⁸ The use of credit score is not permitted.²⁹ Based on a study by the Consumer Federation of America, low-income drivers in U.S. cities pay 59 percent more for auto insurance than those with higher incomes. In Los Angeles, this gap is just 9 percent, likely due to the regulations that California places on insurers.³⁰

MOVING FORWARD

The sides of this debate are well drawn. Medical providers, trial lawyers, and patient advocates have fought all efforts to reduce PIP payouts. Those representing high-poverty areas of the state have resisted reforms that fail to address the use of non-driving related factors in setting insurance rates. Insurers push back against efforts to restrict the use of non-driving factors, arguing that they need this information to create actuarially sound models.

Important to this conversation is the fact that not all Michigan residents are impacted by this problem equally. To the extent that higher income residents feel pinched by the cost of auto insurance, the challenges faced by low-income Michiganders and residents of Detroit in particular are much worse. Given this, any solution to the car insurance quagmire should seek to both: 1) reduce rates and 2) narrow the gap between what Michigan's wealthiest and poorest residents pay for auto insurance. Only in doing so can Michigan end a cycle of poverty that puts Michiganders and our state, as a whole, at a competitive disadvantage.

27 Oosting, J. [2018, June 13]. El-Sayed: To cut auto insurance rates, end 'exploitation'. Retrieved from <http://www.detroitnews.com/story/news/local/michigan/2018/06/13/el-sayed-auto-insurance-reforms/597333002/>; Reindl, J. [2018, August 24]. Detroit mayor sues Michigan over high no-fault auto insurance rates. Retrieved from <https://www.freep.com/story/money/2018/08/23/no-fault-auto-insurance-lawsuit-mike-duggan/1071905002/>

28 Some States Take Aim at 'Discriminatory' Auto Insurance Pricing. (n.d.). Retrieved from <http://www.pewtrusts.org/en/research-and-analysis/blogs/state-inequality/2015/08/28/some-states-take-aim-at-discriminatory-auto-insurance-pricing>; Feltner, T., & Heller, D. (2015). High Price of Mandatory Auto Insurance in Predominantly... Retrieved from https://consumerfed.org/wp-content/uploads/2015/11/151118_insuranceispredominantlyafricanamericancommunities_CFA.pdf

29 California also requires "best price" guarantees for good drivers, has a state-run low-cost plan for safe low-income drivers, and requires insurance companies to provide documentation of their methods.

30 Bjorhus, J. [2016, June 28]. If you're poor, you'll pay more for car insurance, study finds. Retrieved from <http://www.startcibuna.com/report-low-income-drivers-pay-59-percent-more-for-car-insurance/384545011/>

Written Testimony of John W. Van Alst
 Attorney, National Consumer Law Center
 and Director of NCLC's Working Cars for Working Families Project
 Before the Committee on Financial Services
 Subcommittee on Oversight and Investigations
 U.S. House of Representatives
 "Examining Discrimination in the Automobile Loan and Insurance Industries"
 May 1, 2019

Chairman Green, Ranking Member Barr, and distinguished members of the Subcommittee, thank you for inviting me here today to discuss discrimination and cars. I offer my testimony on behalf of the low-income clients of the National Consumer Law Center.¹

I am an attorney with the National Consumer Law Center. On a daily basis, NCLC provides legal and technical consulting and assistance on consumer law issues to legal services office, government attorneys, and private attorneys representing low-income consumers across the country. I direct NCLC's Working Cars for Working Families project which works to ensure that families get a fair deal when buying and financing a car and that the lack of a car does not stand in the way of families' ability to become economically successful. We seek to bring transparency and fairness to the markets for used cars and car finance. We also promote solutions to help non-profit car-ownership programs that assist struggling families to get a car.

A car often provides not only physical mobility but also economic mobility. In many places a car is needed to get to work, access affordable housing alternatives, and take advantage of educational opportunities. Cars are also very expensive to buy. In 2018, the average used car price exceeded \$20,000² and the average interest rate for a consumer with sub-prime credit buying a used car was over 16%.³

Yet for some the costs of buying, financing, and using a car can be even greater based on their race or ethnicity. Consumers of some races and ethnicities are sometimes charged hundreds and even thousands of dollars more to finance a car⁴ and are charged more for the car itself.⁵ They are more likely to be pressured to buy add-on products such as service contracts, sometimes

¹ The National Consumer Law Center is a nonprofit organization specializing in consumer issues on behalf of low-income people. We work with thousands of legal services, government and private attorneys, as well as community groups and organizations, from all states who represent low-income and elderly individuals on consumer issues.

² Nathan Bomey, Used car payments hit record \$400 per month as prices top \$20,000, USA Today, Nov. 8, 2018.

³ Experian, State of the Automobile Finance Market, Fourth Quarter 2018.

⁴ Cohen, Mark A. Imperfect Competition in Auto Lending: Subjective Markups, Racial Disparity, and Class Action Litigation, available at: <http://ssrn.com/abstract=951827>.

⁵ Ian Ayres, "Fair Driving: Gender and Race Discrimination in Retail Car Negotiations," 104 Harv. L. Rev. 817 (Feb. 1991); Ian Ayres and Peter Siegelman, "Race and Gender Discrimination in Bargaining for a New Car," The American Economic Review, Vol. 85, No. 3 at 304-321 (Jun. 1995) (analyzing over 300 paired audits and finding that white male car buyers were quoted significantly lower prices than African American or female buyers). See also Ian Ayers, "Further Evidence of Discrimination in New Car Negotiations and Estimates of Its Cause," 94 Mich. L. Rev., 109 (1995).

being told that the add-ons are required,⁶ and then are charged more for those same add-ons.⁷ Attempting to negotiate for better terms has been shown to not be effective to address these disparities.⁸

These disparities make cars more expensive for some races and ethnic groups and keep some families from getting a car at all. They contribute to the differences we see in the ability of families to get a car. Of households that are at or below the poverty line, 13% of White households lack access to a car, compared to 31% of African American households and 20% of Hispanic households.

Many disparities arise because the market for cars is troublingly opaque and inconsistent. A more consistent and transparent marketplace would not only benefit consumers of color but all marketplace participants, including car dealers, finance entities, and insurers that want to compete fairly and openly on price and quality on a level playing field. To move toward this goal, federal and state policymakers should:

- **Ban dealer interest rate markups.** Any compensation paid to the dealer as part of the financing process should not be based on the interest rate or other financing terms, and should be consistently applied to all transactions.
- **Amend the Equal Credit Opportunity Act (ECOA) regulations (Regulation B)** to enable and require the collection and analysis of race and ethnicity data for auto financing transactions.
- **Prohibit discrimination in the pricing of goods and services.**
- **Increase enforcement of the ECOA.**
- **Increase enforcement against general abuses in the sale and financing of cars.** Given the evidence of discrimination in the sale and financing of cars, it is likely that many other abuses, from yo-yo sales to failure to pay off existing liens, are more likely to affect people of color. Stepped-up enforcement against all abuses in the sale and finance of cars could help address disparities and level the playing field for everyone.

We have attached a draft of our forthcoming report, *Time to Stop Racing Cars*, which was written in preparation for this hearing. Also attached are our reports *Auto Add-Ons Add Up: How Dealer Discretion Drives Excessive, Arbitrary, and Discriminatory Pricing* (2017) and *New Ways to Understand the Impact of Auto Finance on Low-Income Families* (2016).

⁶ Delvin Davis, *Non-Negotiable: Negotiation Doesn't Help African Americans and Latinos on Dealer-Financed Car Loans*, Center for Responsible Lending, January 2014, available at: <https://www.responsiblelending.org/other-consumer-loans/auto-financing/research-analysis/CRL-Auto-Non-Neg-Report.pdf>.

⁷ John W. Van Alst, Carolyn Carter, Marina Levy, and Yael Shavit, National Consumer Law Center, *Auto Add-Ons Add Up, How Dealer Discretion Drives Excessive, Arbitrary, and Discriminatory Pricing* (October 2017), available at: <https://www.nclc.org/issues/auto-add-ons-add-up.html>

⁸ Delvin Davis, *Non-Negotiable: Negotiation Doesn't Help African Americans and Latinos on Dealer-Financed Car Loans*, Center for Responsible Lending, January 2014, available at: <https://www.responsiblelending.org/other-consumer-loans/auto-financing/research-analysis/CRL-Auto-Non-Neg-Report.pdf>.

I commend the Subcommittee for holding today's hearing on such an important topic. We stand ready to work with this Subcommittee and other interested parties in bringing consistency, transparency, and fairness to the auto market. Thank you.



DRAFT
TIME TO STOP RACING
CARS: The Role of Race and Ethnicity
in Buying and Using a Car

May 2019

By

John Van Alst
National Consumer Law Center®

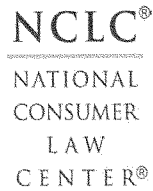
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ABOUT THE AUTHOR

John Van Alst is a staff attorney at the National Consumer Law Center and is the director of NCLC's Working Cars for Working Families project whose focus includes deceptive practices law, automobile fraud, rural issues, warranty, and manufactured home issues. Prior to joining NCLC John was an Attorney with Legal Aid of North Carolina. He was also the Chair of the North Carolina Consumer Law Task Force. He spent one year as a Visiting Clinical Supervisor at the University of North Carolina School of Law's Civil Clinical Program supervising law students representing low-income clients. He is a graduate of the University of North Carolina School of Law. He is co-author of NCLC's *Automobile Fraud, Consumer Warranty Law, and Repossessions*.

ACKNOWLEDGMENTS

The authors would like to thank National Consumer Law Center colleagues Carolyn Carter and Jan Kruse for review and to Anna Kowanko for production assistance.



ABOUT THE NATIONAL CONSUMER LAW CENTER

Since 1969, the nonprofit National Consumer Law Center® (NCLC®) has used its expertise in consumer law and energy policy to work for consumer justice and economic security for low-income and other disadvantaged people, including older adults, in the United States. NCLC's expertise includes policy analysis and advocacy; consumer law and energy publications; litigation; expert witness services, and training and advice for advocates. NCLC works with nonprofit and legal services organizations, private attorneys, policymakers, and federal and state government and courts across the nation to stop exploitive practices, to help financially stressed families build and retain wealth, and advance economic fairness.

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TABLE OF CONTENTS

INTRODUCTION	2
CONSUMERS FINANCING A CAR FACE HIGHER INTEREST RATES BASED ON RACE AND ETHNICITY	2
CONSUMERS FACE HIGHER PRICES FOR A CAR BASED ON RACE AND ETHNICITY	5
CONSUMERS FACE HIGHER PRICES FOR ADD-ON PRODUCTS BASED ON ETHNICITY ..	5
TRYING TO NEGOTIATE FOR BETTER TERMS DOES NOT NECESSARILY HELP AVOID DISCRIMINATION	8
CONSUMERS EXPERIENCE INCREASED CAR INSURANCE RATES BASED ON RACE AND ETHNICITY	8
DRIVERS OF COLOR FACE INCREASED LIKELIHOOD THAT FINES OR FEES WILL RESULT IN DRIVER'S LICENSE SUSPENSIONS	10
THE IMPACT OF THESE PRACTICES ON THE COST OF CARS AND ACCESS TO A CAR 10	
THE NEED FOR PUBLIC AND PRIVATE ENFORCEMENT OF FAIR LENDING LAWS	13
CONCLUSION AND RECOMMENDATIONS	14
ENDNOTES	16
CHART 1: Interest Rate Mark-ups Charged to African American vs. White Consumers at Five Captive Auto Creditors	4
CHART 2: Average Dealer Markup by State for Hispanics and Non-Hispanics for Service Contracts in Dollars	6
CHART 3: Average Dealer Markup by State for Hispanics and Non-Hispanics for Service Contracts in Percent	6
CHART 4: Service Contract Markup by Six California Dealers for Hispanics and Non-Hispanics, in Dollars	7
CHART 5: Service Contract Markup by Six California Dealers for Hispanics and Non-Hispanics, in Percent	7
CHART 6: Insurance Rates for Majority African Americans vs. Low Percentage of African Americans by Zip Code	9
CHART 7: Households At or Below Poverty Without Access to a Vehicle, by Race or Ethnicity ...	11
CHART 8: Households Above Poverty Without Access to a Vehicle, by Race or Ethnicity	11
CHART 9: Metro Area vs. Non-Metro Area Households Above Poverty Without Access to a Vehicle, by Race or Ethnicity	12
CHART 10: Metro Area vs. Non-Metro Area Households At or Below Poverty Without Access to a Vehicle, by Race or Ethnicity	12

INTRODUCTION

For most households in the United States a car is vital not only for physical mobility but also for economic mobility. Car access improves families' economic outcomes in a variety of ways. In the short term, having a car provides access to more and better job opportunities and expanded affordable housing options. In the long term, research has shown shorter commute times, which are often possible only with a car, to be one of the strongest factors in helping families escape poverty.¹ Transportation has a stronger role in social mobility than other community characteristics, including elementary school test scores, percentage of two-parent families, or crime.² In addition to shorter commute times, access to a car often means access to childhood extracurricular opportunities, better food options, and medical care in most areas of the country.

Given the importance of cars, it is deeply concerning that a number of analyses have shown that the costs of buying, financing, and using a car vary based on the consumer's race or ethnicity. These studies have shown that a consumer's race or ethnicity can:

- Increase the cost of credit to finance a car;
- Increase the price of the car itself;
- Increase the price of add-ons sold with the car;
- Reduce the ability of consumers to successfully negotiate for better terms;
- Increase car insurance rates; and
- Increase the likelihood that civil fines or penalties will result in driver's license suspensions.

Studies show that African Americans and Hispanics and Latinos face higher car financing costs even when their credit scores, income, and other indicators of credit worthiness are just as good as whites³, and that they face higher liability insurance costs even if their driving history is just as good as whites.⁴

This report describes these studies. It then highlights how federal and state policy can be improved to encourage a transparent and consistent marketplace for cars that reduces or eliminates these disparities and makes the marketplace for cars fairer for all consumers and businesses dealing in good faith.

CONSUMERS FINANCING A CAR FACE HIGHER INTEREST RATES BASED ON RACE AND ETHNICITY

About 80% of car buyers obtain financing for the car at the dealership.⁵ Dealers are the initial creditors but in most cases they have already arranged to sell the financing contract to a bank, finance company, or credit union before the car is even sold. These finance entities compete against each other to get dealers to send them these deals. One way they compete is to allow dealers to mark up the interest rate and keep some of the extra interest consumers pay. Each finance entity will tell the dealer the interest rate it is willing to take in a particular transaction

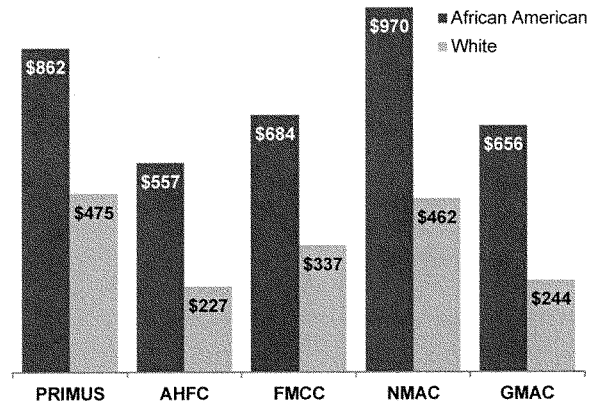
based on the consumer's credit record (the buy rate). But the finance entity, in an effort to convince the dealer to send it the deal, will allow the dealer to mark that interest rate up and keep much of the markup.

Dealers make much of their profit from marking up interest rates. An analysis by the Center for Responsible Lending found that car buyers who financed at the dealership in 2009 paid \$25.8 billion in interest rate markups.⁶

These markups are not applied consistently to every consumer. As a result, consumers with the same credit risk can pay very different interest rates, depending on how much the dealer marks up the interest rate for that particular customer. Consumers have no way of knowing that their interest rate is being marked up or by how much. Even those charged with supervising auto finance for fair lending purposes find it difficult to see if there is racial bias in these markups because the Equal Credit Opportunity Act (ECOA) prohibits the collection of race data for consumers financing a car.⁷

Analyses by Professor Ian Ayers⁸ of the Yale Schools of Law and Management and Professor Mark A. Cohen⁹ of Vanderbilt University's School of Management in connection with class action litigation between the late 1990s to early 2000s against major automobile creditors¹⁰ exposed the fact that minority car buyers were marked up more often and by a greater amount than other car buyers.¹¹ The analysis used in this litigation matched finance markup information with the drivers licenses of car buyers in states that included race data on their licenses. Professor Cohen's analysis looked at over three million transactions in which the dealer assigned the financing to a captive creditor (typically a wholly-owned subsidiary of a car manufacturer that provides financing for the sale of that manufacturer's new cars). It showed that African Americans were marked up more often than whites and that their average markup was higher (see Chart 1).¹² Since the buyer's credit score and other indicia of credit worthiness are already included in the buy rate, the differences in markup were not a reflection of any differences in credit worthiness.

Chart 1: Interest Rate Mark-ups Charged to African American vs. White Consumers at Five Captive Auto Creditors



Source: *Imperfect Competition in Auto Lending: Subjective Markup, Racial Disparity, and Class Action Litigation*, Mark A. Cohen (Dec. 14, 2006). *Note*: Primus Automotive Financial Services is a wholly-owned subsidiary of Ford Motor Corporation and services many non-Ford brands such as Mazda, Volvo and Jaguar. Accordingly, Primus was considered a captive lender for purposes of Cohen's analysis. The full names of the other auto finance companies are: American Honda Finance Corporation, Ford Motor Credit Corporation, Nissan Motors Acceptance Corporation and General Motors Acceptance Corporation.

This troubling pattern has persisted. The Consumer Financial Protection Bureau (CFPB) and the U. S. Department of Justice (DOJ) determined that over 235,000 people of color car buyers were charged higher interest rates for their car loans between April 2011 and December 2013.¹³ This analysis focused on just one major car financing company, Ally Financial, Inc. Subsequent enforcement actions based on similar analyses followed against American Honda Finance Corporation, Fifth Third Bank, and Toyota Motor Credit Corporation.¹⁴ In these analyses, the CFPB used surname and geography as a proxy for race.¹⁵

Subsequent research has continued to show differences in financing terms between white and minority car buyers. In 2018, the National Fair Housing Alliance released findings from testing it conducted in 2016 and 2017.¹⁶ The testing involved teams consisting of a white tester and a better qualified non-white tester, each of whom went to the same dealership to ask about purchasing the same new car. The better qualified non-white testers were quoted more expensive financing options than the white testers, with their average total payment \$2,662.56 higher than the white testers.

CONSUMERS FACE HIGHER PRICES FOR A CAR BASED ON RACE AND ETHNICITY

Several studies have also found that some races and ethnicities are charged higher prices not only for car financing but also for the car itself. Two studies by Ian Ayres in 1995 found that African Americans were quoted higher prices than whites.¹⁷ These studies used testers, so there was no need to use surname or geography as a proxy for race and ethnicity.

A 2003 analysis of more than half a million car purchase transactions at over 3,500 dealerships made similar findings.¹⁸ The authors made inferences regarding car buyers' race or ethnicity by using census blocks. They found that among in-person car buyers, African Americans and Hispanics paid approximately 2% more than other consumers. While about 65% of the price difference could be explained by income, education, and other traits, the remainder could not.

Several studies have also found that some races and ethnicities are charged higher prices not only for car financing but also for the cars.

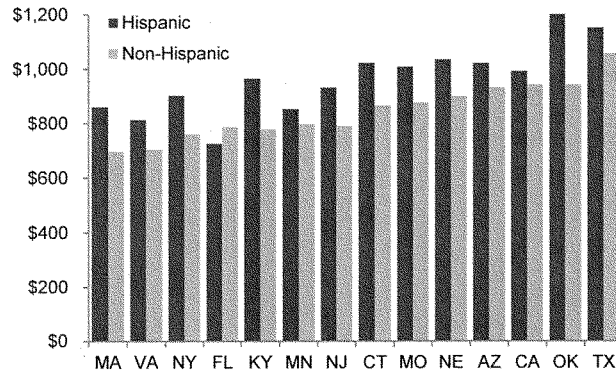
CONSUMERS FACE HIGHER PRICES FOR ADD-ON PRODUCTS BASED ON ETHNICITY

Final numbers for cars and the cost of financing them (including interest rate markups), are typically determined in the finance and insurance (F&I) office at the dealership. In these offices, many car add-on products, such as service contracts, GAP policies (meant to cover any gap between the amount the consumer's insurance pays when a car is stolen or totaled and the amount the consumer owes), and window etching (etching the Vehicle Identification Number on windows as a way to discourage theft, often including some insurance-like coverage), are also sold.¹⁹ Perhaps not surprisingly, the prices for these products are often higher for some people than others.

In 2017, National Consumer Law Center (NCLC) examined millions of these add-ons that are sold to consumers as part of the car sale transaction.²⁰ We found that variation between what consumers were charged for the same product was often dramatic. Many dealers charged one consumer hundreds or even thousands of dollars more than another consumer for the same product. Some examples of these different charges for different consumers were astounding. One dealer, who paid \$50 for a window etching product, marked the price up to as low as \$349 for some consumers and as high as \$5,000 for others.²¹

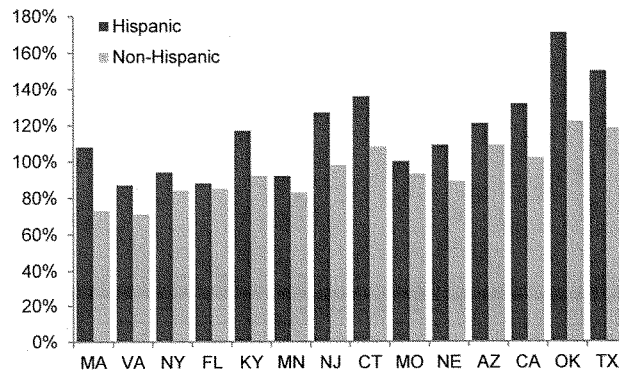
As with other discretionary charges in auto sales and finance, NCLC found that where there was discretion and inconsistency, there was disparate impact by ethnicity. Examining service contract data from 48 states and the District of Columbia, NCLC found that average percentage markups for service contracts were higher for Hispanics than for non-Hispanics in 44 states.²² To make sure that we was not drawing unwarranted conclusions, we focused our analysis on states in which the number of transactions and other factors led to results with a high degree of statistical certainty and for which the difference in markups on both an absolute and percentage basis was statistically significant.²³ We still found that Hispanics were charged more (see Chart 2).

Chart 2: Average Dealer Markup by State for Hispanics and Non-Hispanics for Service Contracts in Dollars



Source: National data set of dealer add-on products sold in the U.S., Sept. 2009 - Dec. 2013

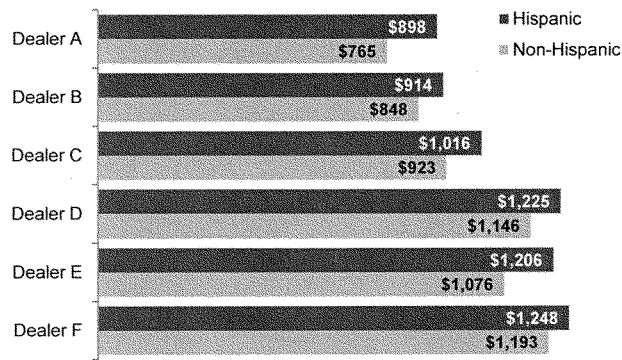
Chart 3: Average Dealer Markup by State for Hispanics and Non-Hispanics for Service Contracts in Percent



Source: National data set of dealer add-on products sold in the U.S., Sept. 2009 - Dec. 2013

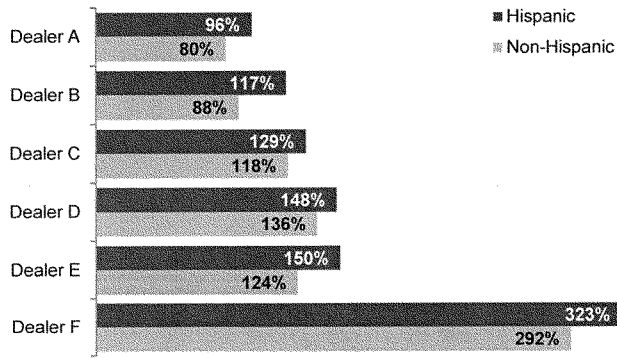
We also saw disparities when we looked at the price of service contracts within individual dealers. We identified six California dealers for which the difference between Hispanics and non-Hispanics for both markup amount and markup percentage was statistically significant. In all cases where both were statistically significant, absolute and percentage markups were higher for Hispanics.

Chart 4: Service Contract Markup by Six California Dealers for Hispanics and Non-Hispanics, in Dollars



Source: National data set of dealer add-on products sold in the U.S., Sept. 2009 – Dec. 2013

Chart 5: Service Contract Markup by Six California Dealers for Hispanics and Non-Hispanics, in Percent



Source: National data set of dealer add-on products sold in the U.S., Sept. 2009 – Dec. 2013

These differences in markups are particularly troubling since they involve the retail prices of service contracts, which are not determined or affected by credit scores. Thus, they cannot be explained by differences in buyers' credit scores.

In addition to higher prices, minorities may be targeted for more add-ons by dealers than other car buyers. A 2014 study conducted by the Center for Responsible Lending found that African

Americans and Latinos were sold multiple add-on products almost twice as often as white consumers. 30% of African Americans and 27% of Latinos were sold multiple add-ons compared to 16% of whites. The study also found that car purchases that included multiple add-ons were associated with higher delinquency rates and greater risk of repossession.²⁴

TRYING TO NEGOTIATE FOR BETTER TERMS DOES NOT NECESSARILY HELP AVOID DISCRIMINATION

One hypothesis that is sometimes suggested to explain why people of color are charged more for cars, financing, and add-on products is that perhaps they just don't negotiate enough to obtain a lower price. Research by the Center for Responsible Lending looking at attempts to negotiate financing terms for car sales at dealers found that African-American and Latino consumers attempt to negotiate financing terms slightly more often than white car buyers yet were still left with worse terms.²⁵

These results are in line with what we might expect from a process that places a great deal of discretion with a dealership employee in an F&I office. The need to quickly size up a potential car buyer and quickly reach the most profitable deal possibly leads many to rely, consciously or subconsciously, on race and ethnicity.

Rick Hackett, former assistant director at the CFPB who represented auto finance companies both before and after his service with the CFPB, quoted one dealer who told him, *"Look, you've got to understand, we've got a very short period of time to figure out the best way to put together all the moving parts of a complex transaction for the consumer, and how we're going to be able to negotiate to have a deal the consumer can accept and is adequate for the dealership. And so we have to make quick judgments when we sort out the process. So when you pick that initial rate for negotiating a finance rate, we all know Asians are better negotiators."*²⁶

CONSUMERS EXPERIENCE INCREASED CAR INSURANCE RATES BASED ON RACE AND ETHNICITY

Even after buying and financing a car, the increased costs faced by some races and ethnic groups continue. Almost every driver must carry insurance. Every state but New Hampshire requires some level of liability insurance and almost every auto finance entity will require a consumer who is financing a car to carry some broader coverage that includes damage to the financed vehicle. This required insurance is a large part of the cost of owning a car.²⁷ A consumer's race can have a large impact on the rates they must pay for insurance.

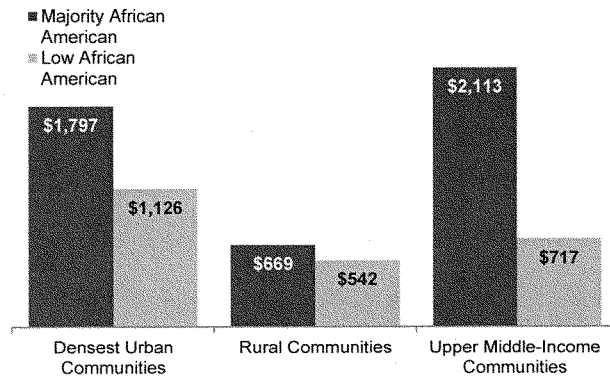
The factors upon which insurance rates can be based vary from state to state. A consumer's age, marital status, gender, credit score, address, type of car, occupation, education, and other factors will often be included in determining what rate a consumer must pay in addition to the consumer's driving record.

In a 2015 analysis, Consumer Federation of America (CFA) found that drivers living in zip codes that were predominantly African American paid higher rates for state-mandated car liability insurance than drivers in predominantly white communities who had similar backgrounds, including driving record, education, employment, and credit rating.²⁸ This was

true for all the five largest insurers in the country, in both urban and rural locations, and true across income levels. The findings were especially telling as the study compared rates for the same driver profile (an unmarried woman with a good driving history, who graduated from high school, held a clerical job, and rented her home) and the coverage was the minimum coverage required the state. The minimum required coverage varies from state to state and may include bodily injury liability, property damage liability, personal injury protection or no-fault coverage, and uninsured/underinsured motorist coverage. Most states require only liability coverage, not any coverage for damage to the consumer's car. This limited coverage focused on liability means that some circumstances that might arguably increase rates in some zip codes, such as frequency of damage to parked cars or stolen cars, would not come into play for setting the rates for statutorily required minimum coverage.

Subsequent analysis by CFA has continued to find racial disparities in insurance pricing. For a 2018 analysis, CFA obtained quotes from six large insurance companies in ten cities. Its analysis showed that residents of zip codes where the quotes were lower were overwhelmingly white (72% on average), while adjacent zip codes where rates were higher had more people of color and were only 29% white, on average.²⁹

Chart 6: Insurance Rates for Majority African Americans vs. Low Percentage of African Americans by Zip Code



Source: *High Price of Mandatory Auto Insurance in Predominantly African American Communities*, Tom Feltner and Douglas Heller, (Nov. 2015)

A 2017 analysis of insurance premiums and payouts in California, Illinois, Texas, and Missouri by *ProPublica* and *Consumer Reports* also found disparate pricing for people of color. It found that insurers were charging premiums that were up to 30% higher in zip codes where most residents were people of color than in whiter neighborhoods, even though the neighborhoods had similar accident costs for the insurers.³⁰

DRIVERS OF COLOR FACE INCREASED LIKELIHOOD THAT FINES OR FEES WILL RESULT IN DRIVER'S LICENSE SUSPENSIONS

There is a host of other costs associated with driving. Given how important the ability to drive is in most of the country, the right to drive is often used as a stick to compel behavior or payments—even on obligations that are unrelated to driving. Across the country a wide array of issues unrelated to driving can result in driver's license suspension, including falling behind on child support, failure to appear in court, writing a bad check, even unpaid student loans. Even among car-related issues many suspensions have no relation to public safety but are instead financial—most states suspend licenses simply for falling behind on, or being unable to afford, fines and fees owed to the government.³¹

This aspect of cars and driving is not immune to differences based upon race and ethnicity. While few would be surprised to learn that rates of driver's license suspensions due to a failure to appear or pay a ticket are correlated with poverty, they may be troubled to learn that they are also correlated with race. There is growing evidence that communities of color, and especially African-American communities, are disproportionately targeted for enforcement of minor crimes and traffic infractions that generate fines and fees.³² Further, because African American families have less wealth to draw upon than white families when hit with unexpected fines or fees, African American motorists are more likely to be unable to pay the amounts assessed.³³

As a result, African American and Latino motorists face higher rates of driver's license suspension than white motorists. A study by the coalition Back on the Road California from 2017 looked in California at the rate of license suspensions due to failure to appear or failure to pay by zip code. It found that of the 75 zip codes studied that had an African American population above 20%, 95% of them had a license suspension rate above the average and almost all the areas with the highest suspension rates had a high proportion of African American residents.³⁴ Additional research in North Carolina has found that the relationship between rates of suspension and poverty varies by race.³⁵

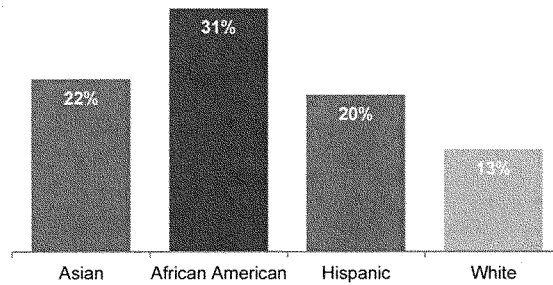
For many people, driving is necessary to maintain employment and health, and thus approximately 75% of people with suspended licenses continue to drive.³⁶ The disparate harm to communities of color thus deepens as African Americans and Latinos are disproportionately arrested for driving with a suspended license, and a debt may begin a cycle of arrests, further fines and fees, and deepening indebtedness and loss of liberty.³⁷ When Back on the Road California looked at data from Los Angeles between 2013 and 2015, it found that although African Americans make up only 9.2% of the population, they represent over 33% of the arrests for driving on a suspended license.³⁸ Similarly Latinos, while making up 48.4% of the population, make up 52.2% of the arrests. Meanwhile, the population is 26.8% white, but whites make up only 14.8% of arrests.

THE IMPACT OF THESE PRACTICES ON THE COST OF CARS AND ACCESS TO A CAR

Given the extent of increased prices for cars, financing, add-ons, and insurance faced by people of color, it is not surprising that they not only pay more for cars than similarly situated white households, but that they are less likely to have access to a car. Of households that are at or

below the poverty line, 13% of white households lack access to a car, compared to 31% of African American households and 20% of Hispanic households (see Chart 7).

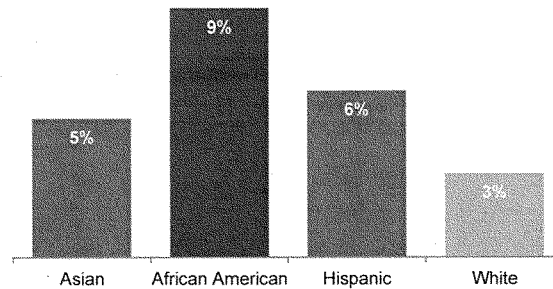
Chart 7: Households At or Below Poverty Without Access to a Vehicle, by Race or Ethnicity



Source: Integrated Public Use Microdata Series: Version 7.0., Steven Ruggles et al., (2016)
 Note: Poverty thresholds are updated each year by the Census Bureau. The federal poverty level for a family of four in 2016: \$24,300.

This disparity holds true for households above the poverty level. Only 3% of white households above the poverty level lack access to a car, compared to double as many Hispanic households and three times as many African American households (see Chart 8).

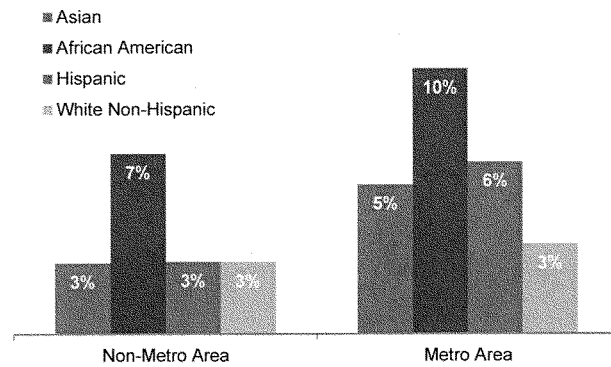
Chart 8: Households Above Poverty Without Access to a Vehicle, by Race or Ethnicity



Source: Integrated Public Use Microdata Series: Version 7.0., Steven Ruggles et al., (2016)
 Note: Poverty thresholds are updated each year by the Census Bureau. The federal poverty level for a family of four in 2016: \$24,300.

It might be argued this disparity could be explained by a higher concentration of African American households living in metro areas with greater access to public transportation. However, even when we break out metro and non-metro areas, the disparity persists both above and below the poverty guidelines.

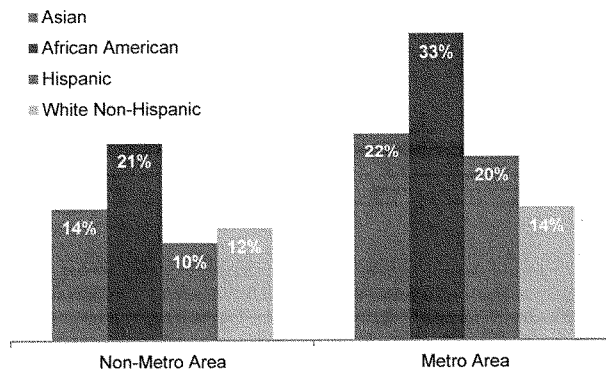
Chart 9: Metro Area vs. Non-Metro Area Households Above Poverty Without Access to a Vehicle, by Race or Ethnicity



Source: Integrated Public Use Microdata Series: Version 7.0., Steven Ruggles et al., (2016)

Note: Poverty thresholds are updated each year by the Census Bureau. The federal poverty level for a family of four in 2016: \$24,300.

Chart 10: Metro Area vs. Non-Metro Area Households At or Below Poverty Without Access to a Vehicle, by Race or Ethnicity



Source: Integrated Public Use Microdata Series: Version 7.0., Steven Ruggles et al., (2016)

Note: Poverty thresholds are updated each year by the Census Bureau. The federal poverty level for a family of four in 2016: \$24,300.

THE NEED FOR PUBLIC AND PRIVATE ENFORCEMENT OF FAIR LENDING LAWS

Public and private enforcement of anti-discrimination statutes is critical if the pricing disparities described in this report are to be eradicated. In the past, strong enforcement actions by governmental and private parties appeared to make some progress. Class actions brought in the late 1990s and early 2000s resulted in settlements with the major auto financing entities. The settlements varied but included caps on interest rate markups, monetary relief to some class members, programs to provide more affordable credit to diverse consumers, interest rate reductions through refinancing, and other terms. The terms agreed to in the settlement of these cases, including the caps, have all now expired.

Starting in 2013, the CFPB and DOJ filed a series of enforcement actions against major car financing entities, based on data analysis by the CFPB that showed that minority car buyers were charged higher interest rate markups than white buyers without regard to credit scores. As a result of the first enforcement action, Ally Financial, Inc. and Ally Bank were ordered to pay \$80 million in damages to harmed consumers and \$18 million in penalties.³⁹ Other enforcement actions followed. American Honda Finance Corporation was ordered to pay \$24 million in damages to harmed African American, Hispanic, and Asian and Pacific Islander car buyers and to change its pricing and compensation system to reduce the risk of discrimination.⁴⁰ Fifth Third Bank was required to pay \$18 million to harmed African American and Hispanic borrowers and change its pricing and compensation system.⁴¹ Toyota Motor Credit Corporation agreed, as part of its settlement, to pay up to \$21.9 million in restitution to African American and Asian and Pacific Islander car buyers who were charged higher interest rates than white borrowers for their auto loans, without regard to their creditworthiness, and to change its pricing and compensation system to substantially reduce dealer discretion and financial incentives to mark up interest rates.⁴²

Enforcement actions like these bring redress to consumers and give companies a strong incentive to examine and reform their financing practices to eliminate pricing disparities. They also make it easier for other finance entities to adopt pricing and compensation systems that reduce dealer discretion and the opportunity for discrimination and still be able to compete.

At the same time as it was bringing these enforcement actions, the CFPB issued a bulletin designed to assist the finance entities over which it had enforcement authority to limit their risk of violating the Equal Credit Opportunity Act (ECOA).⁴³ This was a proactive step to help financing companies move forward and avoid the practices that led to disparate pricing.

In recent times, however, the ability to guard against discrimination in financing cars has become more uncertain. All of the settlements reached in the class actions expired as of 2012, and similar private actions are unlikely given the widespread use of arbitration clauses and certain Supreme Court decisions that impede class actions. In addition, those class actions relied on state driver's license information to determine the race of borrowers, but the number of states that record race data on driver's licenses has declined, and the ECOA does not require or allow data about race or ethnicity of car buyers to be collected.

These restraints on the ability of consumers to address discrimination through private litigation have made vigilant enforcement of fair lending laws by public entities all the more important.

However, in 2018, Congress passed a joint resolution disapproving the bulletin that the CFPB issued in 2013 to help financing entities avoid ECOA violations. There were also indications that the attitude of the CFPB towards enforcing fair lending laws was changing. CFPB Acting Director Mick Mulvaney was widely quoted as saying at a speaking engagement that the Bureau would be “reexamining the requirements” of the ECOA and that if the rate of violations were not frequent “maybe — it’s evidence of a lack of criminal intent, and maybe there’s a good place ... for me to execute some prosecutorial discretion.”⁴⁴

As the changes at the CFPB in regard to the enforcement of fair lending laws became apparent, the market was quick to react. Large auto finance entities, such as BB&T and BMO Harris Bank, had implemented compensation systems that paid dealers a flat fee, rather than one that varied based on the terms of the credit, for assigning car financing contracts to them. Both reverted to policies that allowed for large variable markups. BB&T, which had implemented a flat fee system in 2015, announced in early 2018 that it was moving to allow maximum dealer interest rate markups of 2% on loans up to 75 months and allow the dealer to keep a maximum of \$5,000 for marking up the consumer’s interest rate.⁴⁵

Meanwhile, despite Congress’s disapproval of the CFPB’s 2013 bulletin, the CFPB’s authority and duty to enforce fair lending laws remains the same.⁴⁶ The FTC also has authority to enforce the ECOA against businesses that fall within its jurisdiction.⁴⁷

CONCLUSION AND RECOMMENDATIONS

The lack of vehicle access has a strong impact on the economic mobility of a family. Addressing the disparities identified can help mitigate disparities in economic success going forward.

A major factor in fostering the disparities that these reports have documented is that the current market for cars is troublingly opaque and inconsistent. Even when they do not result in discrimination, these problems harm consumers in general. Car prices, financing costs, and

A more consistent and transparent marketplace would not only benefit consumers of color but all marketplace participants, including car dealers, finance entities, and insurers that want to compete fairly on price and quality on a level playing field.

prices for add-ons are all decided behind closed doors. This process favors dealerships, as they are repeat players with superior knowledge and are very good at extracting the most profit from these deals that they can. In particular, dealers that are upfront and consistent about the cost of cars, add-ons, and financing are at a competitive disadvantage compared with dealers that are not.

A more consistent and transparent marketplace would not only benefit consumers of color but all marketplace participants, including car dealers, finance entities, and insurers that want to compete fairly on price and quality on a level playing field. To move toward this goal, federal and state policymakers should:

- **Ban dealer interest rate markups by statute or rulemaking.** Any compensation paid to the dealer as part of the financing process should not be based on the interest rate or other financing terms, and should be consistently applied to all transactions.
- **Amend the ECOA regulations (Regulation B)** to enable and require the collection and analysis of race and ethnicity data for auto financing transactions.

- **Prohibit discrimination in the pricing of goods and services.** The ECOA prohibits discrimination in the terms of credit but there is no similar protection for the pricing of goods and services.
- **Increase enforcement of the ECOA and state fair lending laws.**
- **Increase enforcement against general abuses in the sale and financing of cars.** Given the evidence of discrimination in the sale and finance of cars, it is likely that many other abuses, from yo-yo sales to failure to pay off existing liens, are more likely to affect people of color. Stepped-up enforcement against all abuses in the sale and finance of cars could help address disparities and level the playing field for everyone.
- **Take action on insurance rate setting.** After reports of the impact of race in insurance costs, the California Department of Insurance began requiring more justification from insurers for their measurement of risk in rate setting and announced that it would “more closely police the clustering algorithms, and their impact on poor and minority neighborhoods, as they review future rate filing applications.”⁴⁸
- **End suspension of driver’s licenses for reasons beyond dangerous driving.**

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consumers, including other consumers who have been historically discriminated against because of race, so the extent of discrimination shown by our analysis was probably understated. In the 34 states in which the difference in markup was not statistically significant on both an absolute basis and a percentage basis, the African American population exceeded the Hispanic population by an average of 13%. In the 14 states for which the differences in both percentage and absolute markup which were statistically significant, the Hispanic population exceeded the African American population by an average of 80%.

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Working Cars for Working Families is a project of the National Consumer Law Center created to ensure that working families can get, keep, and use a reliable car at fair terms.

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AUTO ADD-ONS ADD UP
HOW DEALER DISCRETION DRIVES EXCESSIVE,
ARBITRARY, AND DISCRIMINATORY PRICING

TABLE OF CONTENTS

EXECUTIVE SUMMARY	1
INTRODUCTION	3
BACKGROUND	4
<i>The Importance of Cars and Car Sales</i>	4
<i>How Dealers Profit in the Car Sale Transaction</i>	5
<i>Types of Add-on Products</i>	6
<i>Some Typical Soft Add-On Products</i>	7
ANALYSIS OF ADD-ON DATA	9
PRICING OF ADD-ON PRODUCTS	10
<i>Comparing Add-on Markups to Markups for Other Retail Products</i>	10
<i>Comparing Add-on Products Markups with Insurance Products</i>	11
INCONSISTENT AND ARBITRARY PRICING	18
<i>Inconsistent and Arbitrary Pricing in Etch Products</i>	18
<i>Pricing Trends in Service Contracts</i>	22
DISCRIMINATION IN PRICING	26
<i>Arbitrary Pricing Leads to Discrimination</i>	26
<i>The Method We Used to Analyze Discrimination in Auto Add-ons</i>	27
OTHER PARTIES WITH A ROLE IN PRICING ADD-ON PRODUCTS	35
<i>The add-on supplier</i>	35
<i>The finance company</i>	36
HOW AUTO CREDITORS AFFECT PRICING	36
<i>Examining Auto Creditor Market Share in Ohio</i>	37
RECOMMENDATIONS	42
<i>Require Transparency in Pricing</i>	42
<i>Root out Discrimination in Pricing</i>	43
CONCLUSION	45
APPENDIX: The Data Used for Analysis in This Report	46

ENDNOTES.....	48
---------------	----

CHARTS AND GRAPHICS

Chart 1 Total Number of Originations by Loan Type.....	5
Chart 2 Add-on Products Sold by Category.....	9
Graphic 1 Sample Advertisement	13
Chart 3 Average Dealer Cost and Markup by State: Service Contracts	16
Chart 4 Average Dealer Cost and Average Markup: GAP.....	17
Chart 5 Average Dealer Cost and Average Markup: Etch	18
Graphic 2 Dealers and Window Etching Pricing	20
Chart 6 What One Dealer in Michigan Charged Different Customers for Etch, May 2013	22
Chart 7 Dealer Pricing for Service Contracts with a Trend Towards a Constant \$1,500 Markup	23
Chart 8 Dealer Pricing for Service Contracts with a Trend Towards Pricing at \$1,999, \$2,495 and \$2,999.....	24
Chart 9 Dealer Pricing for Service Contracts with a Trend to Use Either a Fixed Price or a Fixed Markup.....	25
Chart 10 Comparison of Two Dealers' Pricing for Service Contracts	26
Chart 11 Average Service Contract Markup for Hispanics and Non-Hispanics in Dollars	31
Chart 12 Average Service Contract Markup for Hispanics and Non-Hispanics by Percentage.....	32
Chart 13 Service Contracts: Average Hispanic and Non-Hispanic Markup by State in Dollars and Percentages Where Dealer Cost is Similar	33
Chart 14 Hispanic and Non-Hispanic Markups for Service Contracts by Six California Dealers in Dollars	34
Chart 15 Hispanic and Non-Hispanic Markups for Service Contracts by Six California Dealers by Percentage	35
Chart 16 Ohio: Creditors' Market Share Where Guaranteed Asset Protection (GAP) Insurance Was Sold	38
Chart 17 Ohio: Creditors' Market Share Where Customer Paid More Than \$900 for Guaranteed Asset Protection (GAP) Insurance.....	39
Chart 18 Ohio: Creditors' Market Share Where Dealer Cost of Guaranteed Asset Protection (GAP) Insurance Was \$150– \$250	40
Chart 19 Ohio: Creditors' Market Share Where Dealer Cost of Guaranteed Asset Protection (GAP) Insurance Was \$150– \$250 and Customer Price Exceeded \$900.....	41

EXECUTIVE SUMMARY

Add-on products sold by car dealers, such as service contracts, Guaranteed Asset Protection (GAP) insurance, and window etching, make up a large share of dealers' profits. They also significantly increase car buyers' costs. While many have questioned the value of these products for consumers, the pricing of these products has received less attention, largely because pricing is not transparent and consumers, and to some extent even regulators, lack information about what car buyers pay for these products. Dealers decide what to charge each consumer and generally only the dealer, the finance company, and the third party provider of the add-on ever know what other consumers are paying.

This National Consumer Law Center analysis of a large data set is a revealing first look at what dealers pay for these add-on products and what they charge consumers. We found that:

- Add-on products are sold at prices far higher than dealer costs. Dealers mark up add-on products more than other similar products are marked up. They mark up add-on products by a far higher percentage than they mark up cars.
- Dealers are inconsistent in the pricing of add-on products, with even individual dealerships charging some consumers many times more than other consumers for the same product with the same dealer cost.
- This inconstant pricing for the same add-ons leads to pricing discrimination, with Hispanics charged higher markups than non-Hispanics.
- Companies that provide car financing play an important role in allowing excessive and discriminatory markups of auto add-ons.

These abuses, damaging enough in themselves, set in place a chain of other consequences for consumers. The expensive add-ons increase the price of cars, putting them out of reach for some consumers. They also increase the loan to value (LTV) ratio for cars, as they increase the amount that consumers finance without providing any real increase to the value of the car. These higher LTVs result in more negative equity, which hurts consumers and other players in the auto sales and finance market because a consumer who owes more than his or her existing car is worth will have a hard time trading it in and buying a new car. High LTVs have also been associated with higher default rates, again harming consumers and the industry as a whole.

We recommend the following steps to help protect car buyers from the abuses described in the report:

- **Dealers should be required to post the available add-ons and their prices on each car in the lot, along with the price of the car.** To prevent the dealer from reintroducing non-transparency by offering discounts to some customers but not others, the prices for the add-on products must be non-negotiable.
- **To root out pricing discrimination, the federal Equal Credit Opportunity Act regulations should be amended to require documentation of the customer's race or**

national origin for non-mortgage credit transactions, as is currently required for home mortgage transactions. If discrimination remains hidden, it will not be possible to end it.

- **State and federal enforcement authorities should investigate discrimination in pricing of add-on products and bring enforcement actions** against a dealer if discrimination is shown. The Consumer Financial Protection Bureau, the Federal Trade Commission, the Federal Reserve Board, and state attorneys general all have authority in this area.

INTRODUCTION

The largest source of dealer profit from car sales at many car dealers is not the sale of the “metal” (the vehicle itself), but the extension of financing and the sale of “add-ons”—items such as service contracts, Guaranteed Asset Protection (GAP) insurance, and window etching. Court cases and federal enforcement actions have cast much attention on dealers’ role in financing. Much less attention has been devoted to the dealer’s sale of add-on products in conjunction with the automobile sale.

This report uses recent data to analyze the pricing of add-ons. Our analysis finds that the pricing of add-ons involves large mark-ups and arbitrary and discriminatory pricing. We then outline recommendations to limit these abuses.

Case Study: The Hard Sell for Add-on Products¹

In early 2013, Sharay Freeman—a nursing student, aide to developmentally disabled adults, and mother of three children—was in desperate need of a reliable, affordable car. She found a 2007 Honda Odyssey advertised for sale by A Better Way Wholesale Autos in Connecticut for \$10,995, and rented a car for the 45-mile drive to the dealership.

When she got there, Sharay asked the dealer what fees would be charged in addition to the advertised sales price. She was told that there would be a conveyance fee, a VIN etching fee, registration costs, sales tax, and a finance charge, and that she had to pay a \$2,500 non-refundable deposit to start the credit application process. The dealer told her the deposit was standard practice and that it would be refunded if her application was not approved, and that she would pay approximately \$320 per month for 42 months. Sharay signed a purchase order for the minivan and later paid the deposit. The purchase order showed a cash purchase price of \$10,995, VIN etching costing \$198, a dealer conveyance fee of \$598, sales tax of 6.35%, and an unspecified amount for registration of the vehicle.

After the dealer called to tell her she was approved for financing, Sharay went to pick up the minivan. When she arrived, the dealer told her that, in order to obtain the financing it had arranged, she had to buy a number of additional add-on products—ones that carry large profits for the dealer. The dealer made a number of proposals with different add-ons, including a tire and wheel package for \$1,390, a service contract for \$1,474, and, in one of the dealer’s proposals, oil changes for life for \$299.

(Continued on next page.)

The Hard Sell for Add-on Products *(continued)*

These add-on products would have increased Sharay's payment to \$447 per month versus the initial quote of \$320 per month—well more than she could afford. Sharay refused, and asked for her deposit back. The dealer refused to return the deposit, leaving her unable to buy another vehicle for a year. Sharay enlisted the help of consumer attorney Dan Blinn, filed an action against the dealer and prevailed at trial and a subsequent appeal. The dealer has appealed the matter again.

The dealer didn't tell Sharay how much it paid for the add-on products that it wanted her to buy, but it was likely marking them up well beyond their cost, making them very profitable. This report shows, based on newly available data, that it is common for dealers to mark up window etching—the add-on product included in Sharay's original contract—by over 300%, and that some dealers mark it up by over 1,000%. Many dealers also mark up other add-on products, including service contracts, by 300% or more. They often have no set prices for these products, but set whatever price they think the consumer can be induced to pay, leading to the potential for discriminatory pricing based on race or national origin.

BACKGROUND

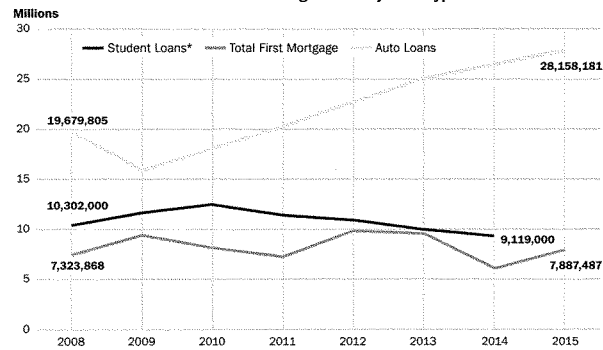
The Importance of Cars and Car Sales

Cars are tremendously important for a family's economic success. They provide not only mobility in a geographic sense—getting people to work, grocery shopping, after-school activities and doctors' appointments—but also mobility in family economic status. Lack of a car can dramatically restrict employment and educational opportunities. Having a car can improve commute time, which a Harvard University study found to be a larger factor in escaping poverty than factors like exposure to crime and the quality of elementary schools.² For many low income families, transportation costs, which are necessary to reach jobs and services, are as high as housing costs.³ For many families a car will be the most expensive purchase they ever make.

Although the total dollar amount of vehicle credit is less than the dollar value of mortgage credit or student loan credit, the number of vehicle financings each year far exceeds the total number of both mortgage and student loans combined.

In addition to the importance of car purchase transactions to individual families, the role of car sales and finance in the broader US economy must not be underestimated.⁴ While total outstanding debt for home mortgages and student loans exceeds car debt, cars are financed much more often. In other words, although the total dollar amount of vehicle credit is less than the dollar value of mortgage credit or student loan credit, the number of vehicle financings each year far exceeds the total number of both mortgage and student loans combined (see Chart 1). Each vehicle

CHART 1
Total Number of Originations by Loan Type



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Sources: Federal Reserve Bank of New York Consumer Credit Panel 15:Q4; Equifax U.S. Consumer Trends, February 11, 2016; Federal Reserve Bank of New York, Student Loan Borrowing and Repayment Trends, 2015 (student loan data through 2014).

* The student loan data represents the number of borrowers originating student loans during a given year, rather than the number of loans originated.

credit transaction gives the dealer a new opportunity to sell add-on products and mark up the interest rate.

How Dealers Profit in the Car Sale Transaction

The sale of financing and add-on products in the dealer's Finance and Insurance (F&I) office is a primary source of profit for car dealers, often eclipsing the profits dealers make from selling the car itself. About 80% of car buyers obtain financing for the car at the dealership.⁵ For these consumers, most dealers line up a bank or other creditor that will be the ultimate creditor that the consumer pays. The creditor that the dealer lines up then tells the dealer the interest rate it is willing to give the consumer in light of the consumer's credit record. But the creditor typically allows the dealer to mark that interest rate up, and keep much of the markup. As a result, consumers with the same credit risk can pay dramatically different interest rates, depending on how much the dealer marks up the interest rate for that particular customer. Dealers make much of their profit from marking up interest rates. An analysis by the Center for Responsible Lending found

that car buyers who financed at the dealership in 2009 paid \$25.8 billion in interest rate markups.⁶

Class action litigation against major automobile creditors has exposed and to some extent limited the abusive practice of dealers' interest rate mark ups.⁷ Analyses by Professor Ian Ayers⁸ of the Yale Schools of Law and Management and Professor Mark A. Cohen⁹ of Vanderbilt University's School of Management have demonstrated the disparate impact on African-Americans of larger and more frequent interest rate markups when compared to white consumers of equal creditworthiness. The Consumer Financial Protection Bureau (CFPB) has also addressed these practices through enforcement actions.¹⁰

Add-on profits often exceed a dealership's profit on the sale of the vehicle itself.

While receiving much less attention than auto financing, the sale of auto add-on products is another huge profit center for dealers. Although most dealers do not disclose information about profits from add-on sales, disclosures made by publicly traded dealer groups are instructive. In the third quarter of 2016, AutoNation Inc. showed an average gross profit from financing and the sale of add-on products of \$1,617 per vehicle.¹¹ Group 1 Automotive Inc.'s financing and add-on profit in the United States was \$1,578 per vehicle.¹² Such profits often exceed a dealership's profit on the sale of the vehicle itself. Although traditionally much, if not a majority, of those profits came from interest rate markups, recently more dealers are deriving a majority of their F&I profits from the sale of add-on products.¹³

Types of Add-on Products

Car dealers sell a dizzying and ever-evolving array of add-on products. Most, however, fall into one of two categories—hard add-ons and soft add-ons.

Hard add-on products are physical items, such as non-standard entertainment systems or navigation systems, curb feelers, pickup truck bed covers, racing stripes, vinyl roof covers, and much more. Hard add-ons have declined in popularity. Not only are many of the items out of style with consumers, but it has become easier for consumers to compare a dealer's prices for hard add-on products with third parties' prices for the same products.

Soft add-on products do not involve a physical product added to the car. Examples are service contracts and various vehicle protection products (see page 7). Soft add-ons are more popular with dealers. They have none of the costs or effort associated with physical products. They require no shipping from the supplier to the dealer, no time to install, and no storage space at the dealership. Notably, it is difficult for customers to understand what they are buying and compare the add-on with other similar products.

This allows dealers to charge higher markups over dealer costs and results in larger dealer profits.

A few products combine aspects of both hard and soft add-ons. For example, customers may be sold rustproofing with a promise of compensation if the car begins to rust within a specified time, or an upholstery or paint protection package with a similar promise of compensation.

Some of the soft add-ons or combination add-ons are either insurance, are regulated as insurance, or are very much like insurance. Whether a product is, in fact, insurance can affect consumers' rights in the transaction. If the product is considered insurance, the dealer may be required to be licensed in order to sell the product and there may be additional regulation of the pricing of the product and the amount and availability of refunds if the product is canceled.

Some Typical Soft Add-On Products

Service contracts, often called extended warranties or breakdown insurance, are written contracts to perform maintenance or repair of a car or other consumer product for a specified length of time or mileage traveled. A service contract can be sold on a vehicle not covered by a warranty or it may supplement a warranty by having a longer duration, covering additional parts or services, or providing additional remedies. Service contracts often pay out only a small portion of premiums in claims and much of the consumer's payment goes to the auto dealer.

Guaranteed Asset Protection (GAP) products ostensibly protect consumers who owe more on their car than the car is worth. Many consumers drive off the dealer's lot owing substantially more than the car is worth. In fact many consumers still owe more than the car is worth when they attempt to trade it in for a new one.¹⁴ This "negative equity"—the amount by which the debt on the car exceeds its value—is attributable not just to depreciation, but also to consumers being overcharged for the car and sold expensive add-ons.

When a vehicle with negative equity is stolen or wrecked, the consumer's collision or comprehensive insurance coverage typically is limited to the value of the car, and is not based on the remaining amount owed on the car financing. The consumer is then liable to the creditor for the amount of the car's negative equity at the time of the theft or accident. GAP products are advertised as holding the consumer harmless for the difference between the balance on the debt and the amount paid under an automobile physical damage insurance policy in the event that the vehicle is totaled or stolen.

Dealers aggressively push GAP products because they are highly profitable. GAP products also reduce risk for the creditor¹⁵ while at the same time adding to the amount financed, thus increasing finance charges. On the other hand, consumers often find that GAP products fail to provide the promised benefits. Most GAP products exclude cars that are uninsured or under-insured and also do not pay for interest and fees accruing from the time the car was totaled or stolen until the insurance payment is made. GAP coverage often excludes that portion of negative equity resulting from a trade-in whose pay-off exceeds its value. It may also exclude the portion of the consumer's obligation that reflects the cost of add-ons, such as service contracts, window etching, and sometimes even the GAP product itself. Some GAP policies also do not cover the deductible on the consumer's collision or theft coverage.

Window Etching (Etch) is one of a number of "vehicle protection products" marketed by dealers as deterring theft or making it easier to identify and recover a stolen vehicle.

The dealer etches an identification number, often the Vehicle Identification Number (VIN), on one or more of the car's windows. The etching supposedly deters theft, but a thief can replace the etched window relatively cheaply and the VIN is already marked in several areas on the car that are much more difficult to find and remove. Etch typically comes with the supposed benefit that, if the vehicle is stolen, the consumer will receive a discount—typically several thousand dollars—on a replacement vehicle. The contract may require the consumer to purchase the replacement vehicle from the selling dealer.

Many dealers etch all the cars on their lot, “preloading” the add-on. Dealers often find this allows them to have a much higher penetration rate,¹⁶ although it sometimes alienates customers. This practice means that, unlike service contracts and GAP insurance, some dealers sell etch products on most of their vehicle transactions while other dealers do not sell etch products at all.¹⁷

Other add-on products not examined specifically in this report include key protection plans, tire protection plans, dent protection, prepaid maintenance, lease products, credit insurance, Certified Pre-Owned (CPO) programs, and warranty products:

- **Key, tire, and dent protection plans** promise to cover all or some of the replacement cost of keys or tires should they be damaged or lost under certain circumstances. Dent protection usually offers to pay claims for a type of paintless dent repair and typically comes with many exclusions.
- **Prepaid maintenance plans** promise to cover regular maintenance costs for a specified period. Dealers like these plans not only because of the profit they receive from the sale of the plan but also because the plans keep the consumer coming back to the dealer, giving the dealer the opportunity to generate more business for its lucrative service department and the potential to sell the consumer another car later on.
- **Lease products** are a growing add-on area, as almost one-third of new car transactions are now leases. While some consumers who lease might be persuaded to buy a few of the usual add-ons, such as key protection, prepaid maintenance, or tire protection, they generally will not purchase a service contract or GAP on a leased vehicle. Accordingly, add-on providers have developed lease coverage products that claim to cover occurrences that might require payment at the end of the lease term, such as the consumer's liability for unusual wear and tear, scratches, and dings. This product usually comes with many exceptions.
- **Certified Pre-Owned (CPO) programs and warranty products** are not typical add-ons because they are included in the price of the car when it is listed for sale, rather than being added separately later. CPO programs provide a certification claiming that a car has been inspected and found to be in good condition. Typically they also provide a warranty for the car. CPO programs may be offered by a vehicle's manufacturer or may be offered by a third party on almost any brand of vehicle. Warranty products are similar to service contracts but are included in a vehicle's sales price.
- **Credit insurance** used to be one of the more common add-ons, but its use by dealers has dwindled. Credit insurance ostensibly pays all or part of the outstanding debt on the car in the event of an occurrence such as death, disability, or unemployment.

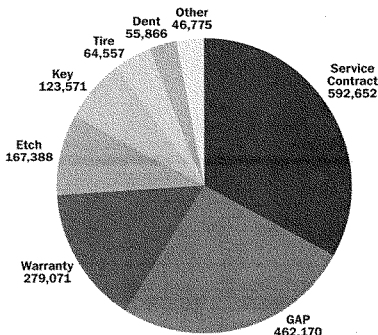
ANALYSIS OF ADD-ON DATA

This report is based on an analysis of a nationwide data set of 1.8 million car sale transactions resulting in the sale of almost 3 million add-on products from September 2009 through June 2015. Included in the data set are transactions involving over 3,000 car dealers selling a wide range of add-on products they purchased from a single third party add-on provider (see Chart 2). A description of the data set is found in the Appendix.

As seen in Chart 2, in the data set, 33% of products sold were service contracts, 26% were GAP, 15% were various warranty-type products, and 9% were Etch. This report focuses on service contracts, GAP, and Etch, as they make up the great majority of products sold for which the consumer is charged a separate fee. Sales of warranty-type products are excluded from our analysis because the consumer's charge for these products is rolled into the price of the car.

The prevalence of service contracts and GAP in our data set is roughly consistent with published information about dealers' penetration rates in selling these products. Industry sources place the penetration rate for service contracts between 38%¹⁸ and 54%,¹⁹ for GAP between about 37%²⁰ and 50%,²¹ and for Etch about 20%. The percentages are different than the percentage distribution by product in our data because the industry data refer to the percentage of vehicle sales that include a specific add-on, while the distribution percentage for our data is the percentage of a particular type of add-on as a percent of all

CHART 2
Add-on Products Sold by Category



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Source: National data set of one provider's add-on products sold in the U.S., September 2009–June 2015.

add-ons sold. Both industry figures and our data are roughly consistent, however, in that both show service contracts as slightly more prevalent than GAP, and both GAP and service contracts as significantly more common than Etch.

Our data set includes sales of add-on products sold by dealers in all 50 states and the District of Columbia. Looking at just the three add-on products examined in this report, the data set includes thousands of sales in most states. In 21 states, the data set includes over 25,000 sales of these three add-on products for that state, and in more than half of those states the number of products sold is greater than 60,000.

PRICING OF ADD-ON PRODUCTS

Comparing Add-on Markups to Markups for Other Retail Products

Car dealers mark up the price of add-on products significantly over the dealer's cost to buy the add-on product from a third party add-on supplier. Looking collectively at service contracts, GAP products, and etch products, the combined average markup was 170%.²² Of course, other retailers also mark up retail prices above cost, but the magnitude of auto add-on markups is often exceptionally high, considering the nature of the product being sold. A review of retail markups more broadly gives some context in which to examine markups of add-on products.

The magnitude of retail markups varies greatly by industry and by product. Brick and mortar retailers, such as big box office supply or sporting goods stores, might mark up their goods by 40 to 50%. Other, more general, big box stores like Costco or Target might have markups between 10 and 50%.²³

Some clothing retailers mark up their goods at a higher rate of 50 to 100%. These higher markups, however, are tempered by frequent sales that result in far lower markups. Styles change quickly and clothing retailers often must sell large portions of their inventory at much lower prices.

Jewelry stores have markups between 25 to 125%²⁴ but typically have a low turnover with significant capital invested in their inventory and high security costs. Furniture stores might mark up their stock by 80%²⁵ but have very large items to store and ship.

Some brick and mortar stores use lower markups. Grocery stores, for instance, often mark staples up only 2 to 8%,²⁶ relying on a large volume of sales and higher markups on more luxurious items. All of these industries are under pressure from online retailers whose costs are reduced because they do not maintain physical stores. Those reduced costs and higher volumes translate into markups averaging 15% for Amazon.²⁷

Car dealers' markup on cars is also illustrative. In the past, dealers marked up the prices of new cars on average about 5 to 10% over the invoice price (the price stated in a document issued by the manufacturer to the dealer).²⁸ Recently this markup has seemingly declined,²⁹ but the reason may be that in response to growing awareness by consumers of invoice price, manufacturers have inflated the stated invoice price so that it exceeds

the dealer's actual cost. For example, the manufacturer's invoice price does not reflect the growing use of various incentive and other payments that manufacturers make to dealers, which can reduce a vehicle's actual cost to the dealer by 2 or 3%. Altogether, the National Automobile Dealers Association (NADA) found that new car sales had a markup of 3.4% in 2015.³⁰ NADA numbers from 2015 for used cars found an 8.6% markup.³¹

Typical car dealer add-ons are very different from cars and other retail products. Soft add-ons, which are the majority of add-on products sold, are not tangible items and need not be shipped or stored or sold at low prices to clear inventory if they go out of style. Dealers do not buy them ahead of time and so do not need to tie up capital for add-on inventory. Unlike cars on a dealer's lot, they need not be insured and the dealer need not obtain financing to keep them in stock. Unlike used cars they need not be reconditioned. These factors should allow dealers to still make a profit while marking up add-ons at a low percentage. However, despite all the advantages of soft add-ons from a dealer perspective, the data indicate that markups of add-ons are typically much greater than those for the cars themselves.

Comparing Add-on Products Markups with Insurance Products

A useful comparison to the size of add-on markups is pricing for insurance products. Insurance does not involve a tangible item and many add-on products, such as service contracts, GAP products, and Etch, have insurance-like qualities.³² For example, the cost to actually etch a number into a windshield is only a few dollars. Much of the alleged value is in the benefit provided to the consumer if the vehicle is stolen.

In general, pricing for insurance products is very different from pricing for non-insurance add-on products. Insurance prices are often reviewed by state regulators. Insurance agents do not mark up prices; instead, the premium (the price for the product) is set by the insurer, and the agent may receive a commission. Pricing discretion is not given to the individual selling the policy.³³ Rather, variations in price are typically based on factors such as the consumer's age, sex, place of residence, marital status, and driving record. While the use of these factors can result in unfair pricing policies,³⁴ they are at least standards that do not leave discretion to the individual employee trying to sell the item to the consumer. Nor is an insurance agent's compensation based on charging different consumers a higher price for the same product as is often the case in the sale of add-ons. (See discussion of compensation of F&I personnel on page 14.) Instead, the insurance agent receives a predetermined commission from the insurance company and there is a fixed pricing schedule. When an insurance policy is sold through an independent agent (somewhat akin to a car dealer selling an add-on), estimates indicate that home and auto policies typically allow a 10 to 15% commission on the first year's premium.³⁵

Insurance prices are typically subject to cost-based pricing requirements – rates may not be excessive, inadequate or unfairly discriminatory and must be reasonable in relation to benefits. With credit insurance products, insurance regulators typically use loss ratios (also termed benefit ratios) to measure value to consumers. These ratios are calculated as benefits paid (claims) divided by premiums collected.³⁶ If for every \$100 in consumer

premium payments, \$80 is paid out to consumers in claims, the insurance product has an 80% loss ratio. Most property and casualty insurance products have loss ratios in the 50 to 65% range.³⁷

Using the same loss-ratio approach to assess the expense of car dealer add-ons reveals that these add-ons are very expensive. Analyzing the exact loss ratios for auto add-on products is difficult due to the lack of available data. In particular, we do not know the exact amount paid out in claims. However, the data used for our analysis does reveal how much of the consumer's payment was kept by dealers as the markup on the product and so unavailable for payment of claims. In other words, the maximum amount available to pay claims is at most the portion of the price that is paid to the third-party add-on provider as the dealer cost for the add-on products. The add-on provider cannot pay more in the long run because it cannot continue to operate if it pays out more than it takes in. This allows us to calculate an upper limit on the loss ratios for these products, and the calculation suggests that loss ratios are shockingly low. In the data we reviewed, the average dealer markup for Etch products was 325% (an average markup of \$189 over the dealer's average cost of \$58) in 2012. For the etch products sold to those consumers, assuming that every penny paid to the third party provider was paid out in claims to the consumers, the loss ratio was still below 25%.

A 2011 advertisement³⁸ (see Graphic 1 on page 13) for Safeguard Products International, LLC—a company that claims to be the top add-on product provider by volume and provides a variety of add-on products, such as service contracts, etch products, GAP, and tire and key protection—provides another illustration of this point. The advertisement (directed to dealers and not to consumers) states that Safeguard has paid out \$600 million in claims,³⁹ and generated \$5 billion in profits for its clients, the dealers.

Even assuming that Safeguard kept only exactly enough money to pay out claims (and did not retain anything for claims adjusting, administrative expenses, marketing, other costs, or profit), these figures would still result in a loss ratio of just 10.7%—\$600 million paid on \$5.6 billion in premium payments. Of course, the loss ratio would be even lower if Safeguard kept an additional part of the consumer's payment for its own costs or as profit.⁴⁰

Even credit insurance, commonly sold by car dealers and notorious for its low pay-out rates and high dealer profits, has a substantially higher loss ratio than this advertisement or our data set suggests for add-on products. In many states there are minimum loss ratios for some types of credit insurance, although these minimum loss ratios can be very low—40%—and actual experience may not even meet this minimum.⁴¹ Yet loss ratios in the area of 40% are double or quadruple the loss ratios our data suggests for add-on products.

Another way to look at add-on pricing in comparison to insurance is to consider the dealer's markup over its cost as compared to the commissions that independent insurance agents receive when they sell insurance to consumers. As described previously, regular insurance agents' commissions typically range from 10 to 15%, which is the equivalent of an 11 to 18% markup.

GRAPHIC 1

Sample Advertisement for Dealers

One Company. One Solution.

Strength. Security. Results.

It's who we are.

- #1 volume F&I product provider.
- Over 200 exceptional agent partners delivering value in all 50 states—*the absolute best in income development.*
- 26 customized OEM private-label programs, more than all other providers combined—*the undisputed leader.*
- \$600 million in claims paid.
- \$5 billion in profits for our clients.
- 15 million consumers protected worldwide.

Safe-Guard is committed to providing exceptional service and profit-driven results. Experience for yourself why Safe-Guard is the industry's leading F&I provider.

Safe-Guard

One Company. One Solution.

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Note: The red circle has been added to the advertisement for emphasis.

By contrast, auto dealers' markups for add-on products are much higher (see charts 3 to 5). In 2012, the average dealer markup for Etch sales in our data set was 325% (an average markup of \$189 over the dealer's average cost of \$58). That same year, the average markup for GAP was 151% (an average markup of \$378 over the dealer's average cost of \$251). The average dealer markup for service contracts was 83% (an average markup of \$859 over the dealer's average cost of \$1,032).

These are average mark-ups across the whole data set. As will be described, there is enormous variation in the extent of markups from dealer to dealer and even from state to state and from consumer to consumer at the same dealer. This implies that actual markups in certain states, at certain dealers, and for certain consumers will be dramatically higher.

For example, an analysis of our data shows that, in 2012, 13 dealers marked Etch products up by an average of over 1,000%. One dealer sold over 1,000 Etch products, each with a dealer cost of \$16 and a charge to the consumer of \$189, for a markup of \$173 or 1,081%. For GAP products, 38 dealers had average markups of 300% or more, and 38 dealers marked up service contracts by an average of more than 300%.

As was true for loss ratios, these markups far exceed those for credit insurance sold by vehicle dealers. Insurance regulations often permit dealers to charge higher commissions for credit insurance than insurance agents are permitted to charge for other types of insurance, but they still usually fall below 35% for credit life and credit disability.⁴² A model credit insurance regulation drafted by the National Association of Insurance Commissioners (NAIC) recommends a 25% cap on compensation paid to creditors such as auto dealers for selling credit insurance.⁴³

Yet another measure of add-on pricing is a comparison of dealer pricing with that by entities that do not appear to view add-ons as a special profit center. Insurance companies and credit unions often offer GAP directly to their existing customers. The GAP contracts offered by these providers are generally priced far lower than those sold by dealers. Currently, the North Carolina State Employees Credit Union offers GAP for a flat fee of \$275 on all new and used vehicles it finances up to \$100,000 in value. By contrast, consumers in our data set who bought GAP at the dealership paid on average \$629 in 2012 and \$655 in 2013.

While all of these markups are high, some products are marked up on average at a much higher percentage than other products. The average markup percentage for service contracts is higher than that for GAP and the average percentage markup for etch products is much higher than either. There are several possible explanations. It could be that dealers with more egregious pricing policies favor certain add-on products, such as Etch. Another likely explanation for some of the difference is that dealers are marking up products that have a lower cost at a higher percentage than items with a higher dealer cost. Dealers might justify this markup structure as necessary to compensate them for the time and money they spend on having and selling the product. While that could justify some more similar absolute dollar markup and higher percentage markups on lower cost items, the overhead on these products is very small.

Another partial explanation for the very high markup on these items is the pay structure for F&I personnel. F&I personnel are often very well compensated,⁴⁴ sometimes making more than the dealership's general manager. The pay of the F&I manager is largely commission based. Some dealers simply pay a flat commission on all F&I profits. Others pay a higher percentage commission as the F&I profits increase per vehicle sold. The F&I manager's commission may be 10% unless he reaches a goal of more than \$1,000 per car, at which point the commission may increase to 12%. On top of the F&I manager's commission, car salespeople also sometimes get a commission, not only for the dealer's profit on the sale of the car itself but also for profit on the sale of add-ons and other "back-end" products. When substantial commissions are based on markup, they incentivize F&I managers to maximize the markup for each consumer on an individual basis.

*Dealers' Expectations for Profits from F&I
can Lead to Consumer Harm*

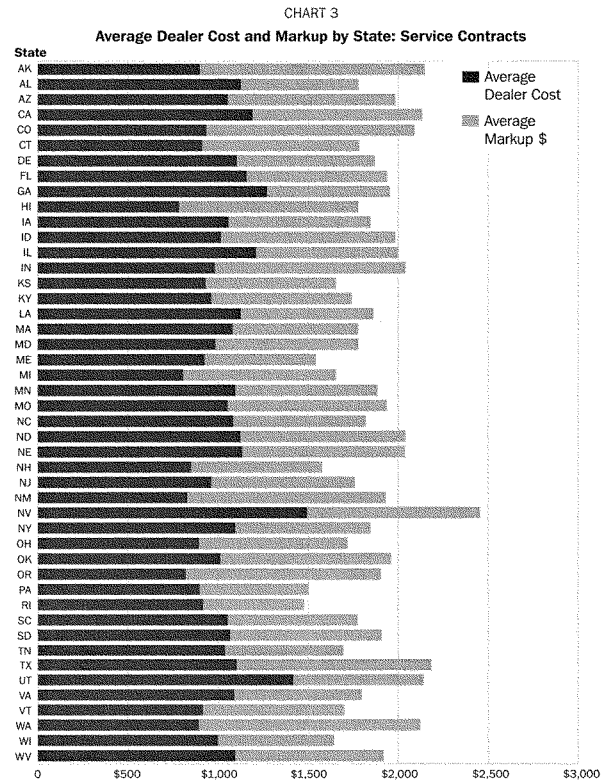
In the latter half of the 2000s, Steve VanGorder became general manager of the dealerships in the Jeff Schmitt Auto Group in Ohio. Faced with an F&I revenue of \$700 or \$800 per vehicle sold, VanGorder set up a system of targets for those in the F&I department based upon factors such as penetration rates. He trained a number of salespersons who were eager to move to the more lucrative F&I department. If existing F&I personnel failed to meet the new targets they could be easily replaced with the trained personnel from the sales department. As VanGorder stated in an interview with *Automotive News*, "If somebody's numbers have fallen in finance, they know there is a talent pool of aggressive salespeople who want their job."⁴⁵

These perspective F&I people are trained to do things the way the dealership wants them done, using a "word track" the dealership wants used. VanGorder described it as similar to contestants who might cover a popular song on the TV show *American Idol*. "The people who can really do a good job with a song, sing the song the way it was originally sung by the artist—they sing it 1,000 times backward and forward until they know it and then they can make it their own," he says. "I'm looking for a willingness to learn the process and the word track. Once they do that, the heavy hitters can make it their own."

The fact that "aggressive salespeople" were ready to replace any F&I personnel who failed to meet their targets appeared to accomplish the goals of the dealership in bringing in more F&I profits. VanGorder's system raised F&I revenue per car from \$700 or \$800 to \$1,600 or \$1,700, and the penetration rate to 85%.⁴⁶

However, while F&I revenue was up, so too were complaints from consumers. In 2013, the Jeff Schmitt Auto Group paid \$625,000 to settle 16 civil lawsuits and five other complaints.⁴⁷ A number of consumers also complained to the Ohio Attorney General.⁴⁸ A number of the former customers, represented by consumer attorney Ron Burdge, alleged that they were charged up to \$1,299 for rust-proofing which subsequent analysis showed was sometimes not applied, and overcharged for other add-ons such as Window Etching. Some customers also described the use of a "five-finger close," where the dealer employee's hand would cover up terms in the paperwork that were different than what the customer had been told orally in the negotiations.

The size of markups varies not only by dealer, but also by state. Charts 3, 4, and 5 show the dollar amount that the service contracts, GAP, and Etch in our data set cost the dealer and the dollar amount they were marked up by state from 2009 to 2013. Only states in which sales of a particular product exceeded 100 are included, so for a less frequently sold product, such as Etch, the chart includes fewer states.

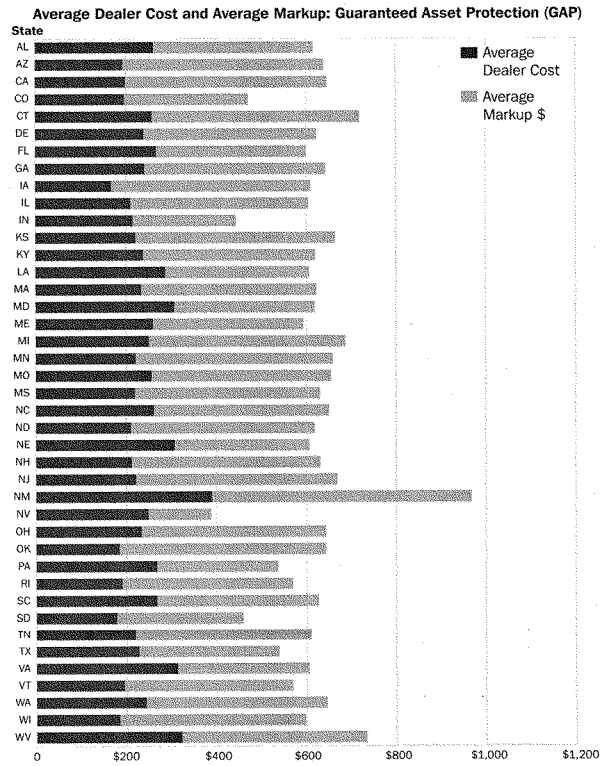


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Source: National data set of one provider's add-on products sold in the U.S., 2012.

Note: Only shows states with 100 or more records.

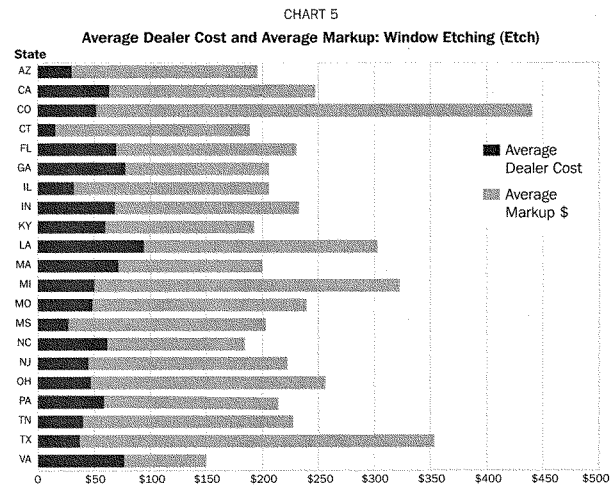
CHART 4



©National Consumer Law Center, 2017

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

Note: Only shows states with 100 or more records.



©National Consumer Law Center, 2017

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

Note: Only shows states with 100 or more records.

INCONSISTENT AND ARBITRARY PRICING

Inconsistent and Arbitrary Pricing in Etch Products

Markups for add-ons are not only extremely high, but also highly inconsistent. Not everyone buying the same add-on with the same dealer cost pays the same price. This inconsistent pricing occurs not just between different dealers or for different products, but within individual dealerships for the same products and even when the dealer's cost for the product is the same. That is, two consumers going to the same dealer and purchasing the exact same product may pay significantly different prices.

Some dealers do require their F&I departments to charge everyone the same price for the same add-on that has the same cost to the dealer, but it is the dealer and not the third

party provider that establishes the price. Dealers may set this price by adding a fixed dollar markup such as \$100 or \$200 to their cost, or by using a consistent markup percentage, such as 100% or 200%. Or they may just set a flat price, such as \$899 or \$999, for each product.

Other dealers do not have fixed pricing, but instead allow the F&I manager to mark up different individual customers at different amounts. The dealer may place a cap on how high the F&I manager can raise the price of an add-on for any particular consumer, but often this cap is just the maximum amount that the creditor that finances the sale will allow the dealer to charge for the add-on product. (See page 36 for further discussion of the role of creditors.) Sometimes the cap is a multiple of the cost of the item.⁴⁹

Whether set by the dealership or made up by the F&I manager on the spot, the prices often are not round numbers. This is often done to add an air of legitimacy to the price and the F&I manager may stick to the made-up price as if it is cast in iron. As one industry magazine put it:

"Utilize odd prices for every F&I product . . . \$2,832 for that service contract, not \$2,795. Odd prices add credibility and legitimacy to F&I product pricing, and reduce the customer's perception that they need to negotiate the price of those products. Help your F&I managers establish a set price for each product, and then encourage them to stick to it. Any reduction in price must always require reciprocity- a reduction in coverage. The first time they ask a customer 'If I could, would you . . .' their credibility goes in the toilet. They might as well go to work at the carnival. The same holds true for interest rates. Whenever possible, use odd interest rates- 5.41%, not 5.25%. Everyone needs to feel like they got a good deal!"⁵⁰

Our analysis reveals some pricing approaches frequently used by dealers. The Etch data show dealers' pricing approaches most clearly because the cost to the dealer for Etch products generally does not vary by the price of the car, whether a car is new or used, or other characteristics that vary from car to car.

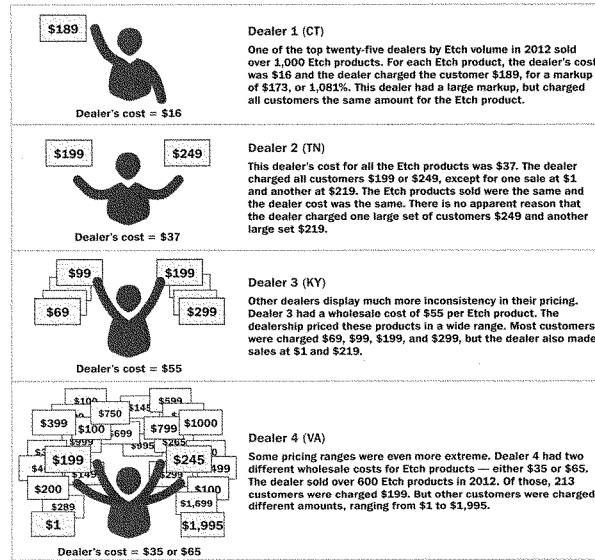
While only some dealers in our data set sold Etch products and the dealer's cost for the Etch product varied from dealer to dealer,⁵¹ in almost all cases each dealer that sold Etch had only one cost for the Etch products it sold. In 2012, there were 124 dealers in the data set who sold the most common Etch product and of those, 105 had just one wholesale cost for every one of this Etch product they sold. Of the remaining 19 dealers, 18 had two different wholesale costs for this Etch product and one had three. Observation of pricing structures is thus easier for Etch than for other add-on products where the dealer cost for a product varies from customer to customer based upon characteristics of the car being purchased, the length of a service contract, and similar factors.

We examined the 25 dealers that sold the most Etch products in 2012, looking at the dealer cost and consumer price for about 41,000 Etch products sold by these top dealers. Graphic 2 (see page 20) shows the pricing structure of several of these top 25 dealers that are representative of typical pricing schemes.

GRAPHIC 2

Dealers and Window Etching Pricing
four dealers, four different pricing patterns

While some dealers with lots of sales of window etching (Etch) charge everyone the same price, it is not typical. In 2012, there were 105 dealers in NCLC's data set that sold Etch products that had just one dealer cost for every Etch product they sold. Only 19 of those 105 dealers sold the Etch product to each of their customers for the same price. 82% of dealers did not have a single fixed price for their Etch products, but established a different price depending on the customer. These extreme pricing inconsistencies cannot be explained by different costs to the dealer, different products being sold, or different time periods.



To increase transparency of pricing and help prevent discriminatory practices, dealers should be required to:

1. Post the available add-ons and their non-negotiable prices on each car in the lot along with the price of the car itself.
2. Collect data about consumers' race and ethnicity as part of the transaction and make the data available, just as mortgage lenders to do.

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

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Dealer 1, one of the top twenty-five by Etch volume in 2012, sold over 1,000 Etch products. For each and every Etch product, the dealer cost was \$16 and the dealer charged the consumer \$189, for a markup of \$173 or 1,081%. This dealer had a large markup, but charged all consumers the same amount for the Etch product.

While some dealers with lots of Etch sales at a high profit, such as Dealer 1, do charge everyone the same price, it is not typical. In 2012 there were 105 dealers in our data set who sold Etch products that had just one dealer cost for every Etch product they sold. Of those only 19 dealers sold the Etch product to each of their customers for the same price.

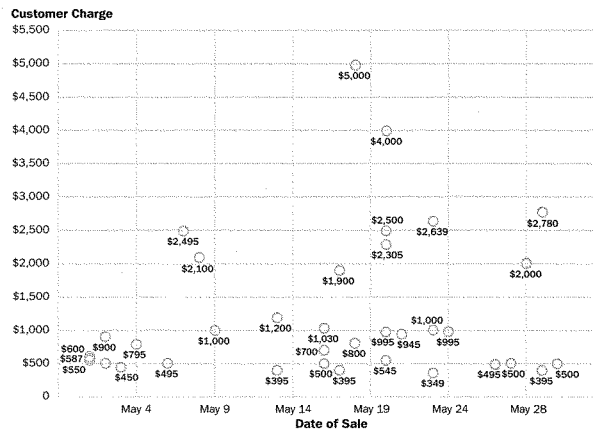
82% of dealers did not have a single fixed price for their Etch products, but established a different price depending on the customer. Some of these dealers stuck to one or two prices most of the time. Dealer 2 had a wholesale cost of \$37 for all the Etch products it sold. It made all of its Etch sales at \$199 or \$249, except for one sale at \$1 and another at \$219. The Etch products sold were the same and the dealer cost was the same. There is no apparent reason that the dealer charged one large set of customers \$249 and another large set \$199.

Other dealers display much more inconsistency in their pricing. Dealer 3 had a wholesale cost of \$55 per Etch product. The dealership priced these products in a wide range. Most sales were at \$69, \$99, \$199, and \$299, but the dealer also made sales at \$1 and \$219.

Some pricing ranges were even more extreme. Dealer 4 had two different wholesale costs for Etch products—either \$35 or \$65. The dealer sold over 600 Etch products in 2012. Of those, 213 customers were charged \$199. But other customers paid prices ranging from \$1 to \$1,995.

These extreme pricing inconsistencies cannot be explained by different costs to the dealer, different products being sold, or different time periods. For example, in May of 2013, a dealer selling the same Etch product with the same dealer cost of \$50 charged customers between \$349 and \$5,000 for this product (see Chart 6 on page 22).

CHART 6
What One Dealer in Michigan Charged Different Customers for Etch, May 2013
 (Dealer's Cost = \$50 for Each Etch Product)

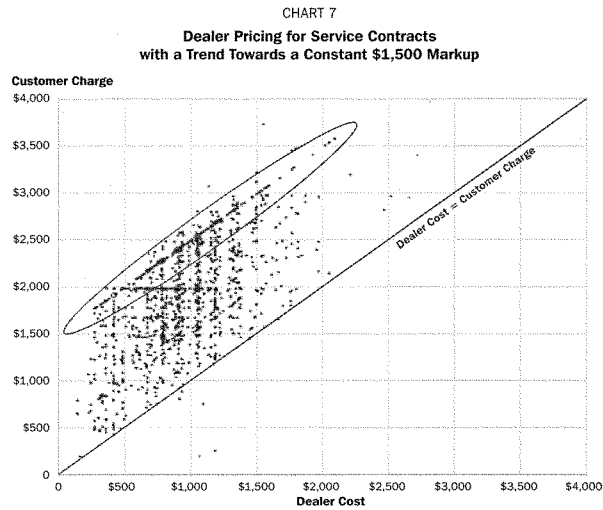


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Source: National data set of one provider's add-on products sold in the U.S., May 2013.

Pricing Trends in Service Contracts

Pricing inconsistencies are particularly easy to identify in a product such as Etch for which the dealer cost is constant, but they also can be seen when the dealer cost varies. A good example of an add-on product where the cost to the dealer varies is a service contract. The dealer cost for a service contract may fluctuate based on such factors as the value of the car, whether it is new or used, the cost of repair, and the length of coverage. Charts 7, 8, and 9 reflect the pricing structure of dealers drawn from the top 20 dealers of service contract sales by volume in 2011. We selected them because they were high volume dealers whose pricing structures reflected some of the general pricing trends we saw among many dealers.

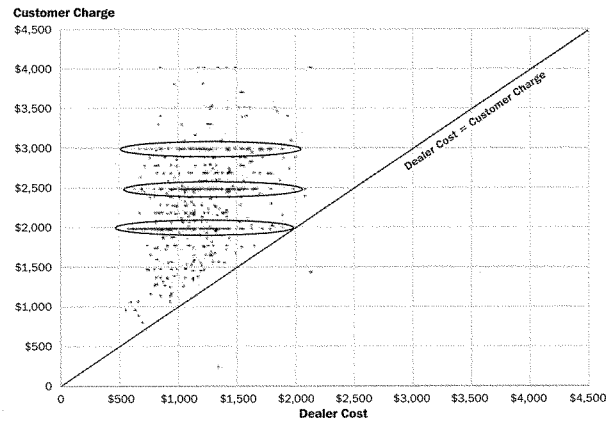


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Source: National data set of one provider's add-on products sold in the U.S., 2011.

Looking at these individual dealers, some trends become clear. Dealers typically use highly variable pricing but do follow some patterns. The dealer shown in Chart 7 often marks up service contracts by \$1,500 as seen by the heavy line of products sold at \$1,500 above the green line. (The green line represents a 0% markup where the consumer price is equal to the dealer cost.) The trend circled in red parallel to the green line indicates a consistent \$1,500 markup regardless of the cost to the dealer. However, this dealer also sells many service contracts with a fixed price of \$2,000 regardless of cost, and sells many at a variety of other prices.

CHART 8
Dealer Pricing for Service Contracts
 with a Trend Towards Pricing at \$1,999, \$2,495 and \$2,999



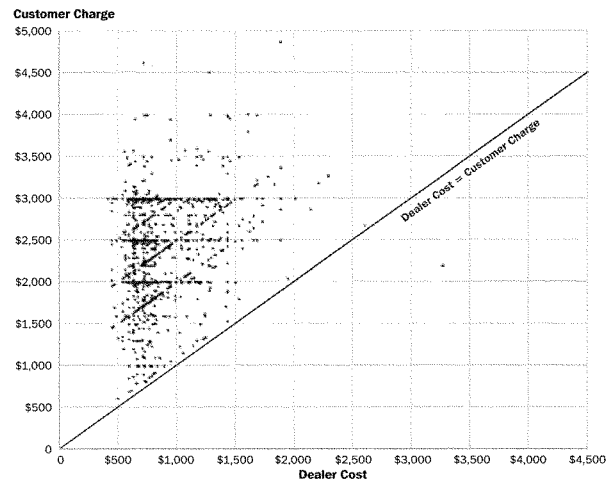
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Source: National data set of one provider's add-on products sold in the U.S., 2011.

Other dealers, such as the one in Chart 8, tend to charge many customers the same price for their service contracts, such as \$1,999, \$2,495, or \$2,999, regardless of the dealer's cost for the service contract.

Some dealers, such as the dealer shown in Chart 9, employ both of these pricing approaches. This dealer often marks up service contracts \$1,000 or \$1,500, but other times prices them at \$1,999, \$2,499, or \$2,999 irrespective of the cost to the dealer. In addition, this dealer, as is the case with many dealers, made a substantial number of sales at prices that followed neither trend and that varied significantly from customer to customer.

CHART 9
Dealer Pricing for Service Contracts
 with a Trend to Use Either a Fixed Price or a Fixed Markup

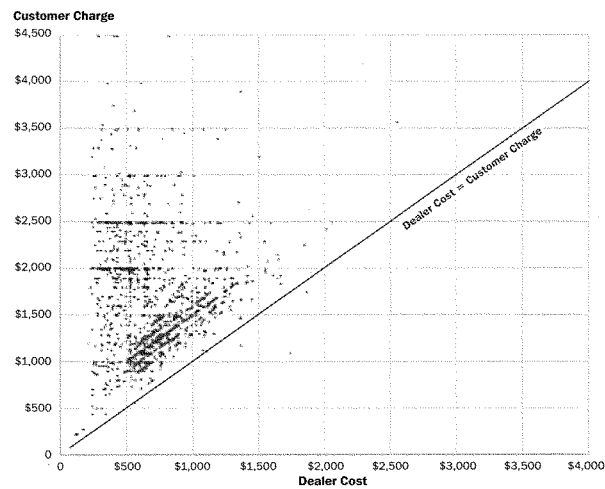


©National Consumer Law Center, 2017

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

The difference between dealers as to markups can be striking (see page 26). In Chart 10, just two of the top 20 dealers are highlighted. On the whole, the dealer highlighted in green marked up many service contracts by \$500, but still sold many more priced above and below a \$500 markup. However, that dealer's markups are, by and large, much lower than the dealer highlighted in red. The dealer in red clearly favors prices of \$3,000, \$2,500, and \$2,000, even though it is selling service contracts for which it pays far less than the dealer in green. The dealer shown in red is selling service contracts with lower dealer costs for much higher prices. Both dealers show a large variation in pricing.

CHART 10
Comparison of Two Dealers' Pricing for Service Contracts



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

DISCRIMINATION IN PRICING

Arbitrary Pricing Leads to Discrimination

Discrimination on the basis of race, sex, or other protected characteristics may be an invidious side effect of dealers' capricious pricing structures. Giving F&I managers the discretion to charge different consumers different prices for the same product and building incentives to charge high prices into their compensation systems is a recipe for abuse. Since one consumer does not know what other consumers are charged for similar items, consumers have no ability even to detect whether they are being charged more than other consumers for the same products.

Discrimination in add-on markups can come about if an F&I manager prices add-on products for a particular customer based on a judgment about what prices that customer can be convinced to pay. The F&I manager might even base the price on whether the manager thinks the customer is likely to notice that the add-on item has been included in the sale. Price disparities can also occur when F&I managers reduce prices for some customers but not for others.

A number of studies have found that pricing discretion given to dealers as to markups of *interest rates* results in African Americans and Hispanics paying higher interest rates than white consumers with the same credit risk.⁵² This discrimination may not be deliberate or even conscious. Unless the F&I manager marks up every customer and uses the same markup for every customer with no negotiation, he or she will have to make a judgment call about whether or not to mark up any individual's financing and if so by how much. Consciously or unconsciously, F&I managers consider a number of consumer characteristics when making this judgment. Dealers may notice the way customers are dressed, their perceived level of educational attainment, and many other characteristics when judging how to price a customer. Race or ethnicity are likely among the characteristics that F&I managers notice when making pricing decisions.

Given that, in many dealerships, the F&I manager who decides what, if any, interest rate markup a particular consumer will pay is the same F&I manager who decides what the markup will be for add-ons, and given that the F&I office often has greater discretion in the pricing of add-ons than the amount of the interest rate markup, one would expect patterns of add-on markups to be similar to patterns of interest rate markups. And, in fact, our analysis found evidence that such discrimination *does* occur in the pricing of add-ons.

The Method We Used to Analyze Discrimination in Auto Add-ons

Our data set did not contain race coding for consumers. Indeed, no automobile data set contains information about the automobile buyers' race. Regulation B, implementing the Equal Credit Opportunity Act (ECOA), prohibits non-mortgage lenders from asking about or documenting characteristics such as a consumer's race or national origin.⁵³

This rule was adopted in an effort to stop lenders from discriminating on these bases. Ironically, in an area like auto sales and finance, where the person with the discretion to set the consumer's interest rate or the price of the car or add-on is sitting across the desk from the consumer and may make assumptions about the consumer's race, the policy does not prevent discrimination, but instead makes it difficult to determine if discrimination occurs. This Regulation B provision has an effect that is counter to the ECOA's purpose.⁵⁴ As several commentators including the U.S. Government Accountability Office have noted, requiring lenders to collect and report such data could actually assist in stopping discrimination.⁵⁵

Giving F&I managers the discretion to charge different consumers different prices for the same product and building incentives to charge high prices into their compensation systems is a recipe for abuse.

Our data set also lacked specific addresses for consumers. Without this information, we could not use the combination of name and geocoding used by the Consumer Financial Protection Bureau to code and analyze auto finance transactions for discrimination.⁵⁶

The lack of information regarding race/ethnicity or specific consumer-level geographic information limits our ability to analyze the data for discrimination. As a result, we employed a simple proxy method, using surnames alone to identify and code likely Hispanic consumers. The Federal Reserve Board uses this technique in fair lending examinations to code for ethnicity. Some entities that provide financing also use this technique internally to monitor for compliance.⁵⁷

We used a list of Hispanic surnames created by the Federal Reserve Board's Office of Fair Lending Enforcement based on the United States Census identification of common Spanish surnames. We coded customers with the surnames from this list as Hispanic and then compared the pricing of add-ons for those with Hispanic surnames compared to those with non-Hispanic surnames.

This method was limited in several respects. The use of surname alone is relatively predictive for Hispanic populations, but it is not as predictive for African American populations without the use of geocoding.⁵⁸ We were therefore unable to code the data for African Americans. Because we were limited to coding for Hispanics using this analysis, when we compared consumers with Hispanic surnames to those with non-Hispanic surnames, we were comparing Hispanics not only to non-Hispanic whites, but also to African Americans and other minorities previously identified as receiving disparate, inferior treatment from car dealers on the basis of interest rates or car prices.⁵⁹ This means that pricing disparities that we identified were likely under-representative of the true extent of the disparities which would have been revealed if we had been able to compare Hispanics to non-Hispanic whites.

We focused our analysis on service contracts for several reasons. Service contracts are the most common and widespread add-on and are sold by almost every dealer in every state. Even within individual dealerships there is typically a wide variation in service contract markup and pricing. While there are trends in service contract pricing, these trends are certainly not controlling. These characteristics made service contracts a better product to look at for pricing disparities by race than Etch. We knew from our analysis of markups and pricing that a number of high volume dealers only charged one price for Etch. If one or more of these dealers had a disproportionately large Hispanic clientele it could strongly affect the pricing trends. It could mean that a disparity we found between Hispanics and non-Hispanics in Etch pricing might be heavily influenced by the demographics at a particular dealership with high etch volume rather than disparities between consumers at any particular dealership. Using service contracts made such effects less likely and the larger number of service contracts sold and dealers selling service contracts made it easier for us to look at individual dealerships and avoid any such influence.

Overall Findings

We examined a three-year period of service contract pricing for which we had service contract data from 48 states and the District of Columbia. Looking at just the average percentage markup for Hispanics and non-Hispanics, we found that average markups for service contracts were higher for Hispanics than for non-Hispanics in 44 states. In two states, the markup was lower for Hispanics and one state and the District of Columbia had no Hispanic coded service contract buyers at all. In one state, the percentage markups for both Hispanics and non-Hispanics were almost identical.

We decided to focus on states where the results would allow us to make observations with a high degree of statistical certainty. Therefore we applied several restrictions. We limited our analysis to states in which our data set had at least 30 Hispanic service contract purchasers. We then applied traditional statistical tests for probability in samples and the nature of sampling error.⁶⁰ Using these tests we further reduced the states we analyzed to those where the number of transactions and other factors led to results with a high degree of statistical certainty.⁶¹

As yet another precaution, we ran two separate analyses for each state. First, we analyzed whether the percentage markups were different for Hispanic-surnamed consumers than for other consumers, and second we analyzed whether the dollar amount of the markups was different. We took this step because a markup of a given dollar amount is a higher percentage of a lower-cost service contract than it is of a higher-cost contract. For example, an \$800 markup is 80% of a \$1,000 service contract, but just 40% of a \$2,000 contract. Thus, higher percentage markups for Hispanic-surnamed buyers could occur if the service contracts sold to Hispanics had a lower dealer cost than those sold to non-Hispanics. This could happen if Hispanics were buying cars for which service contracts had a lower dealer cost (because the cars themselves were less expensive or had lower repair costs) or if dealers sold Hispanics service contracts with lower levels of coverage and consequently lower dealer costs. To avoid the possibility that some of the differences we found between Hispanics and non-Hispanics might be attributable to this scenario, we focused our examination only on the states where the difference was statistically significant by both measures—percentage and dollar amount. In 14 states the difference was statistically significant by both measures.

In some of the states where the pricing differences between Hispanic-surnamed consumers and others were not statistically significant, the explanation was likely due to the fact that the volume of overall sales or the number of Hispanic-surnamed customers from our data set was too low to draw conclusions. We suspect that the lack of a statistically significant difference in many of the other states may be due to the issue previously discussed that our method coding those with Hispanic surnames forced us to compare consumers with Hispanic surnames to all of those with non-Hispanic surnames. As a result, we were comparing Hispanics not only to non-Hispanic whites, but also to African Americans and other minorities previously identified as receiving disparate, inferior, treatment from car dealers on the basis of interest rates or car prices.⁶²

State demographic data support our belief. Of the 48 states for which we had service contract data during the relevant period, 14 had differences in both percentage and absolute markup which were statistically significant. In the 34 states for which only one or neither measure was statistically significant, the African American population exceeded the Hispanic population by an average of 13%. In the 14 states for which the differences in both percentage and absolute markup which were statistically significant, the Hispanic population exceed the African American population by an average of 80%.⁶³

Analysis of Particular States

In each of the 14 states in which the differences in BOTH absolute and percentage markups were statistically significant, Hispanics were sold add-ons with higher percentage markups than non-Hispanics. In 13 of the 14 states (Florida was the exception), the average markup amount was also higher for Hispanics than non-Hispanics in absolute dollars (see Charts 11 and 12).

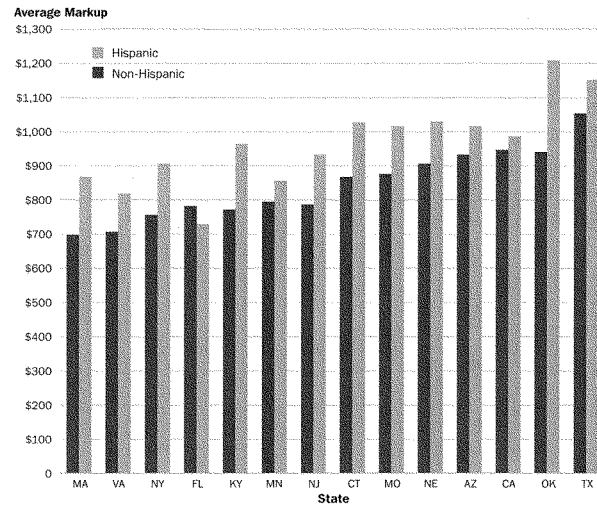
These differences in markups are particularly troubling since they involve the *retail* prices of service contracts, which are not determined or affected by credit scores. Thus, they cannot be explained by differences in buyers' credit scores.

In Florida, the Hispanic percentage markup was higher but not the absolute dollar markup. As previously noted, if a dealer charges a set dollar amount as a markup on all the service contracts it sells, the percentage markup will be higher for a lower-cost service contract than for a higher-cost contract. If Hispanics were sold service contracts that had a lower cost for the dealer and some dealers followed this type of pricing policy, this could explain why they paid a higher percentage markup but not a higher dollar amount markup. The unusual pattern could also be explained by the very high number of Hispanics in Florida and the possibility that some dealers might favor Hispanics in pricing.⁶⁴

Markup disparities between Hispanics and non-Hispanics persisted when we further controlled for the dealer cost of the service contracts by looking at products sold with similar dealer cost: (see Chart 12 on page 32). Overall, Hispanics still paid more than non-Hispanics.

We analyzed prices for service contracts that cost the dealer between \$910 and \$1,010 (see Chart 13). (We selected this range because it went from \$50 more to \$50 less than the \$960 average cost for service contracts sold to Hispanics in the 14 states). Looking only at this tight range of costs to the dealer, we still see higher dollar and percentage markups for Hispanics in 12 of the 14 states, with markups almost the same for both groups in Kentucky and lower for Hispanics in Florida. Thus the discrepancy cannot be attributed to the varying costs of the service contract to the dealer.

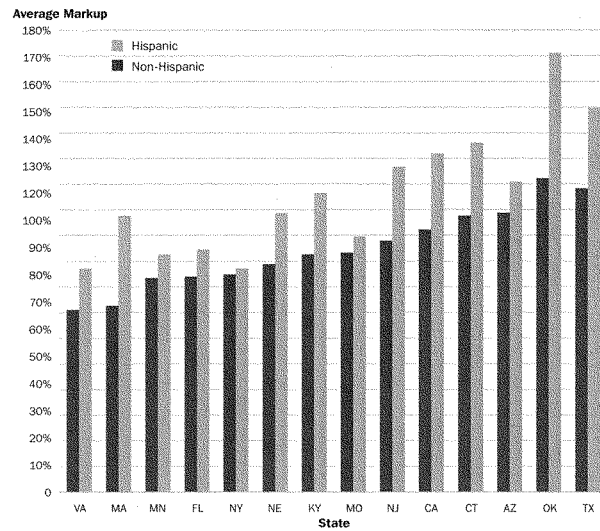
CHART 11
Average Service Contract Markup for Hispanics
and Non-Hispanics in Dollars



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

CHART 12
Average Service Contract Markup for Hispanics
and Non-Hispanics by Percentage

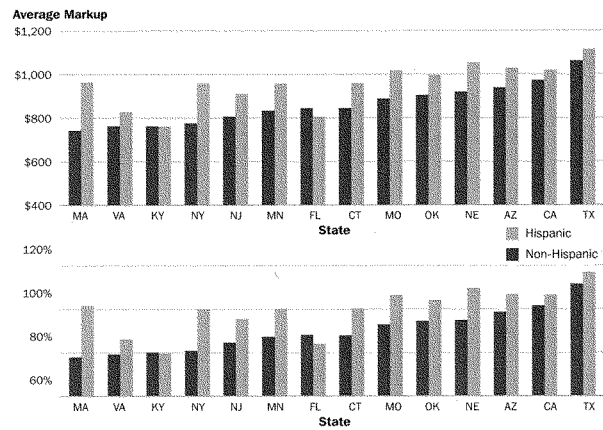


©National Consumer Law Center, 2017

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

CHART 13

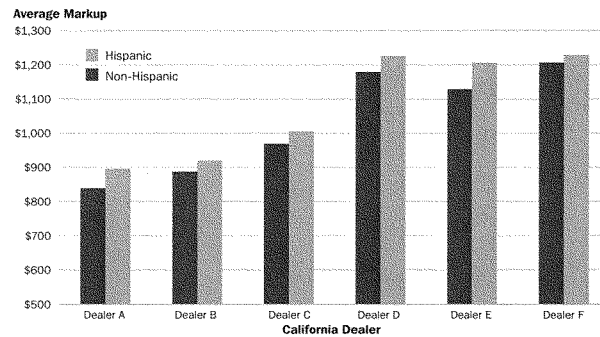
**Service Contracts: Average Hispanic and Non-Hispanic Markup by State
in Dollars and Percentages Where Dealer Cost is \$910 to \$1,010**



©National Consumer Law Center, 2017

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

CHART 14
**Hispanic and Non-Hispanic Markups for Service Contracts
 by Six California Dealers in Dollars**

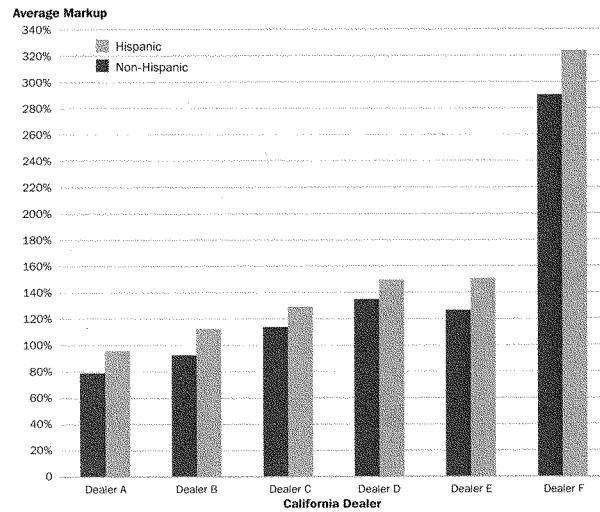


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Source: National data set of one provider's add-on products sold in the U.S., 2011

We also see disparities when we look at the data by dealer. The next two charts show six dealers in California with a large number of Hispanic consumers (see Charts 14 and 15) and for which difference between Hispanics and non-Hispanics for both markup amount and markup percentage is statistically significant. In all cases where both are statistically significant, absolute and percentage markups are higher for Hispanics.

CHART 15
**Hispanic and Non-Hispanic Markups for Service Contracts
 by Six California Dealers by Percentage**



©National Consumer Law Center, 2017

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

OTHER PARTIES WITH A ROLE IN PRICING ADD-ON PRODUCTS

The add-on supplier

The amount that the dealer pays for third-party add-ons is set by the third-party supplier. Other than setting the dealer cost, however, these companies exercise very little control over the consumer pricing of add-ons. There are no suggested retail prices or other set pricing.

The add-on companies or their agents sometimes provide training and recommendations regarding pricing policies, but they allow the dealer to make the decisions regarding consumer pricing. The add-on supplier does keep track of the consumer prices charged by dealers. This is at least in part so that the dealer and the add-on supplier can calculate the portion of the consumer's price that each is responsible for refunding if the consumer cancels the purchase of an add-on product.⁶⁵

The finance company

While the third-party suppliers of add-on products exercise almost no control over the price the dealer charges for add-ons, car finance companies do exert control because of their self-interest in reducing defaults and retaining adequate security on the credit they extend.

The vast majority of cars that are financed are financed at the dealership. When a car is financed at a dealership, the extension of credit can be structured in one of two ways. Most commonly, the dealer itself extends credit to the consumer by agreeing to accept installment payments. The consumer signs a retail installment contract agreeing to make payments to the dealer. The dealer then assigns that contract almost immediately to a bank or finance company and the consumer's obligation is then to that assignee.

Less commonly, the dealer arranges a loan directly from a bank or other financing company to the consumer. The lender pays the loan proceeds to the dealer, and the consumer repays the lender. With this financing structure, the consumer's obligation is to the lender from the start.

No matter how the financing is structured, the dealer has to obtain advance approval from the bank or finance company for the terms of the deal. In this report, we use the term "creditor" to describe the bank or finance company in both situations.

HOW AUTO CREDITORS AFFECT PRICING

Potential creditors—banks, credit unions, and finance companies—give dealers rate sheets or other programs that set out the conditions under which they may be willing to finance car sales originated by that dealer. These conditions are often very specific, as the potential creditor wants to ensure that the car buyer is likely to make the scheduled payments. The creditor also wants to make sure that if the buyer does not make the expected payments and the car is repossessed, the value of the car will cover at least a high percentage of the credit extended. The conditions specified in the rate sheets will include the consumer's minimum income and credit score, the maximum amount financed, the permissible age and mileage of the car, and much more. Some creditors that specialize in financing car purchases for consumers with subprime credit scores require certain payment-to-income ratios or debt-to-income ratios. Potential creditors also typically indicate how much they will allow dealers to mark up the interest rate.

Potential creditors also set limits on the price the consumer is charged for add-ons. These limits reflect the creditor's real self-interest. Because most add-ons have little value to the consumer and almost no value to any purchaser of a repossessed car, they represent an amount the creditor is essentially lending with no real collateral. These excessive costs can also make it more likely that the car buyer will default, as the consumer's monthly payment will be higher to cover the add-on. Both outcomes can harm creditors.⁶⁶

Usually, creditors set limits by specifying the maximum loan to value (LTV) ratio the creditor will accept. The amount financed is inflated by the cost of valueless add-ons. Creditors typically must allow some level of price inflation because if they don't, the dealer will use a different finance company that allows them to have more expensive add-ons for a larger dealer profit. At some point, however, the add-ons inflate the financed amount too high above the value of the car and the creditor may refuse to finance the deal. Some creditors require that the LTV fall within a certain range both when the purchase of just the car is considered, and when both the car and the add-ons are considered. These are referred to as the front end and back end LTVs. Creditors also often have specific limits for add-ons, such as caps on the price of GAP or service contracts or caps on the price of the total of add-ons.

While creditors are cautious about add-ons, several trends have increased their willingness to allow high-priced add-ons. First, federal challenges have limited how much creditors are willing to offer dealers on interest rate markups.⁶⁷ Simultaneously, there has been an increase in the desirability of auto finance as an investment because it offers high rates and relatively low defaults, resulting in more and more potential creditors competing to finance car sales for dealers.⁶⁸ Since there are new limits on how effectively they can compete for dealers' business with interest rate markups, many have been forced to compete with more permissive rules about add-ons and LTVs. This trend of increasing LTVs due in part to add-ons has been noted not only by those in the industry but even by the Office of the Comptroller of the Currency (OCC).⁶⁹

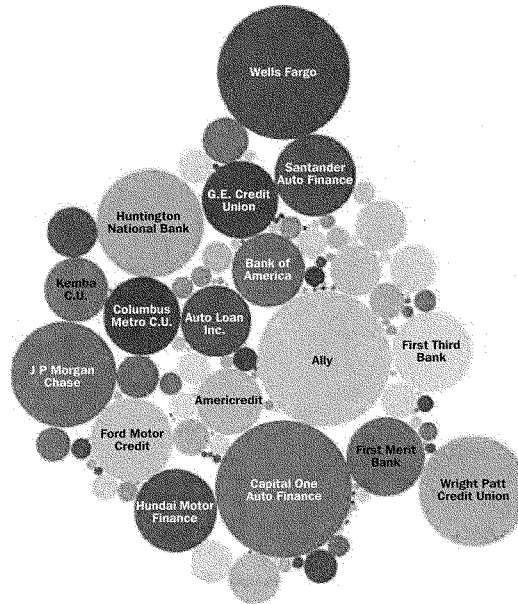
The limits that creditors set can have a real impact on what happens to consumers. We examined the data to see if dealers marked up add-ons more for transactions financed by particular creditors, which would suggest that some creditors allowed larger markups for the add-ons. The nature of the data set only allowed analysis of transactions by creditors in Ohio.⁷⁰

Examining Auto Creditor Market Share in Ohio

Charts 16 and 17 look at which creditors financed car sales in Ohio in which a GAP product in our data set was sold. As chart 18 shows, there are many auto creditors active in the Ohio auto finance market. While some national and regional finance companies have a larger market share, no one is particularly larger than all others.

The relative market share of individual companies changes, though, when we only look at transactions where customers were charged more than \$900 for the GAP product (Chart 17). Ally Bank is over-represented when GAP products are over this amount.

CHART 16
Ohio: Creditors' Market Share Where Guaranteed Asset Protection (GAP)
Insurance Was Sold*



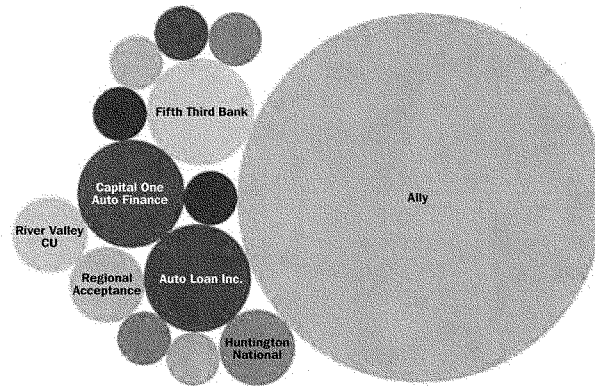
*Companies with the largest market share are identified.

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Source: National data set of one provider's add-on products sold in the U.S. 2007-2013, and title information obtained from Ohio county title offices and made available by the Ohio Department of Public Safety and the Bureau of Motor Vehicles.

CHART 17

Ohio: Creditors' Market Share Where Customer Paid More Than \$900 for Guaranteed Asset Protection (GAP) Insurance*



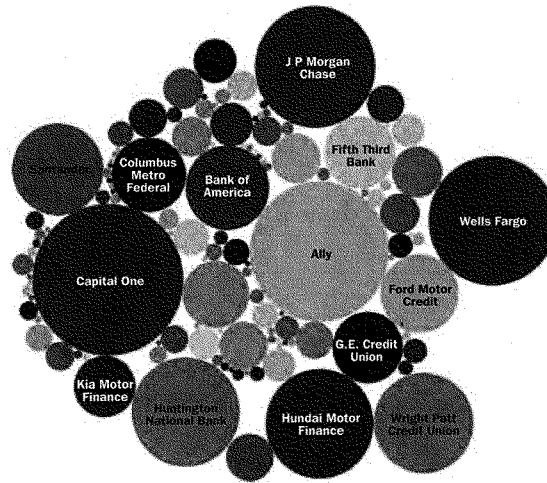
*Companies with the largest market share are identified.

©National Consumer Law Center, 2017

Source: National data set of one provider's add-on products sold in the U.S. 2007-2013, and title information obtained from Ohio county title offices and made available by the Ohio Department of Public Safety and the Bureau of Motor Vehicles.

Just because Ally financed more car sales where the GAP cost was high does not necessarily mean that the dealers' markups were also high. Theoretically, the dealers whose sales Ally financed may have been selling more expensive GAP products, and marking them up no more than other dealers. However, the data shows that this is not the case: Ally not only financed a disproportionate share of deals that included high-priced GAP products, but also financed a disproportionate share of deals that included a high markup for the GAP product. Ally financed just 10% of the deals where the dealer cost for the GAP product was between \$150 and \$250 (see chart 18), but it financed 73% of those same deals where in the consumer's price exceeded \$900 (see chart 19). Indeed, only two other creditors financed *any* such deals.

CHART 18
Ohio: Creditors' Market Share Where Dealer Cost of Guaranteed Asset
Protection (GAP) Insurance Was \$150–\$250*



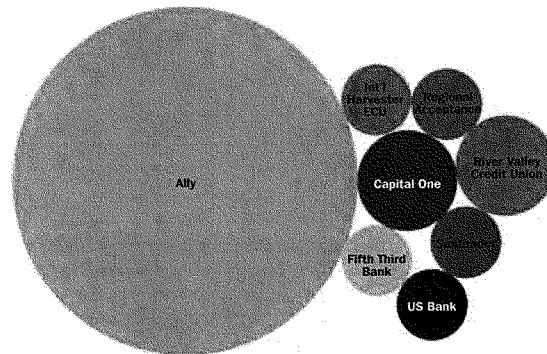
*Companies with the largest market share are identified.

©National Consumer Law Center, 2017

Source: National data set of one provider's add-on products sold in the U.S., 2007–2013, and title information obtained from Ohio county title offices and made available by the Ohio Department of Public Safety and the Bureau of Motor Vehicles.

CHART 19

Ohio: Creditors' Market Share Where Dealer Cost of Guaranteed Asset Protection (GAP) Insurance Was \$150–\$250 and Customer Price Exceeded \$900



©National Consumer Law Center, 2017

Source: National data set of one provider's add-on products sold in the U.S., 2007–2013, and title information obtained from Ohio county title offices and made available by the Ohio Department of Public Safety and the Bureau of Motor Vehicles..

RECOMMENDATIONS

Existing practices in the sale of add-on products result in high—sometimes extraordinarily high—markups and inconsistent pricing. Inconsistent pricing is unfair to all consumers, and also leads to discriminatory pricing for Hispanics and very likely for other minorities. Current practices also lead to excessively high loan to value ratios, saddling consumers with negative equity and creditors with unnecessary risk. The current pricing practices and lack of transparency distort the market and force dealers who would rather compete on car price and quality to instead follow the practices of dealers who rely on the F&I office and opaque and secretive pricing for their profits. The following recommendations address these problems.

The origin of many of the problems with add-on products is that there are no posted or ticketed prices for the products. Consumers should be able to see the price of add-ons *before* negotiating to purchase a vehicle.

Require Transparency in Pricing

The starting point for addressing these issues should be transparent pricing. The origin of many of the problems with add-on products is that there are no posted or ticketed prices for the products. Consumers should be able to see the price of add-ons *before* negotiating to purchase a vehicle. Posted pricing would allow the market for add-ons to operate more efficiently and encourage market forces to address some of the most egregious abuses we see in pricing. New York City has successfully implemented a city-wide ordinance that requires the price of both the car and any add-on products offered with the car to be posted on each car offered for sale by a used car dealer in the city.⁷¹

We recommend that all new and used vehicle dealers be required to post the available add-ons and their prices on each car in the lot along with the price of the car itself. To prevent the dealer from reintroducing non-transparency by offering discounts to some customers but not others, the prices for the add-on products must be non-negotiable.

In theory, an alternative would be to post the prices of add-on products in the dealership office. However, the price of some add-on products, such as service contracts and GAP, depends on the price and other characteristics of the individual car being sold. Some add-ons will not be available for particular cars. Also, prices posted inside the dealership would not be visible to those browsing on the lot and might not be seen when the consumer comes inside. Because of these complexities, posting prices on each individual car is preferable. Posting the prices on a general basis for all vehicles offered by the dealership is probably not even feasible, as a price list would likely be so voluminous and complex that it could not even be posted in any readable form.

Making the pricing of add-ons transparent by posting the prices on the car would go a long way toward solving problems with add-on products. It would prevent “opportunity pricing” or “sucker-pricing,” and would probably deter discriminatory pricing as

well. Anyone who bought a particular vehicle would pay the same price for the add-ons for that vehicle.

Root out Discrimination in Pricing

Our report suggests that troubling discriminatory pricing is occurring in the sale of add-on products. It is imperative that retailers such as car dealers not charge different customers different prices because of their race or ethnicity.

Transparency in pricing—our first recommendation—would go a long way toward ending discriminatory pricing. However, dealers could still price add-ons inconsistently from car to car, and could steer particular consumers to those cars. Dealers could also make a “harder” push for add-on sales or for particular add-ons for some targeted consumers. Moreover, transparency in pricing is not yet the law in most jurisdictions, but is only our recommendation. For these reasons, we recommend several additional steps.

A fundamental obstacle to rooting out discrimination in pricing is that, under current law, this type of discrimination is extremely difficult to detect. This is because Regulation B, implementing the Equal Credit Opportunity Act (ECOA), prohibits non-mortgage lenders from asking about or documenting a consumer’s race or national origin.⁷² By contrast, for home mortgage transactions federal law *requires* lenders to ask about and document the applicant’s race and ethnicity.⁷³

This rule was adopted in an effort to stop creditors from discriminating on these bases. Unfortunately, in auto sales and finance, where the person with the discretion to set the consumer’s interest rate or the price of the car or add-on is sitting across the desk from the consumer, the policy does not prevent discrimination. Rather, Regulation B makes it difficult for enforcement entities and even the creditors themselves⁷⁴ to determine if discrimination is occurring. Perversely, this is counter to the purpose of the ECOA.⁷⁵ As the U.S. Government Accountability Office and others have noted, requiring collection and reporting of such data could actually assist in stopping discrimination.⁷⁶

We recommend two steps to root out discrimination in pricing.

1. **Regulation B should be amended to require documentation of the customer’s race or national origin for non-mortgage credit transactions.** Regulation B’s restriction is *not* required by the ECOA itself, so this change could be adopted by agency action.⁷⁷ If discrimination remains hidden, it will not be possible to end it.
2. **State and federal enforcement authorities should investigate discrimination in pricing of add-on products.** Our ability to evaluate discrimination was limited by the fact that we did not have customer addresses, so could not geocode. In addition, the data set we analyzed includes sales of only one provider’s add-on products. State and federal enforcement authorities typically have the ability to issue administrative subpoenas to obtain a wide range of data once they have reason to believe that illegal practices are occurring. These authorities should obtain more detailed data about pricing, analyze it for discriminatory patterns, and bring enforcement actions if discrimination is shown.

Tips for Consumers Considering Purchasing Auto Add-On Products

The current lack of transparency in pricing for auto add-on products makes it difficult or impossible for consumers to protect themselves. The current lack of transparency in pricing for add-on products makes it difficult or impossible for consumers to protect themselves. Until state and federal policymakers and enforcement authorities reform this market, consider the following tips when purchasing a car from a dealer.

- **Avoid buying add-on products when buying a car.** Very often, these products are overpriced and of low value.
- **If you want to buy Guaranteed Asset Protection (GAP) insurance, check with your insurance agent and your bank or credit union prior to purchasing.** Many insurance agents and some banks and credit unions provide GAP insurance directly to consumers, typically at more reasonable prices than dealer pricing.
- **Finance the car directly through a credit union, bank, or other lender, if possible.** Consumers are generally better off if they arrange financing for a car purchase from their own bank or credit union. Make sure to pin down the cash price of the car from the dealer *before* disclosing your financing arrangements—otherwise the dealer might increase the cash price. There can, however, be two advantages of having the dealer arrange the financing:
 - 1) when the dealer arranges the financing, then an FTC rule makes the creditor responsible, along with the dealer, for deception or breach of warranty by the dealer; and
 - 2) a few customers may be eligible for incentive financing (such as 0%) from the manufacturer that other lenders cannot match.

For more information about service contracts, see *Consumer Reports*, “Skip the vehicle service contracts” (July 27, 2011), available at <http://www.consumerreports.org/cro/news/2011/07/don-t-buy-a-troublesome-automotive-service-contract/index.htm>, and the FTC brochure “Auto Service Contracts and Warranties” (August 2012), available at <https://www.consumer.ftc.gov/articles/0054-auto-service-contracts-and-warranties>.

CONCLUSION

As this report shows, average markups by dealers for add-on products are high, and sometimes extraordinarily high, averaging over 1,000% at some dealerships. These markups are higher than comparable markups of retail goods and insurance products.

Not only are markups for add-ons high, but there is also a great deal of inconsistency in pricing of add-on products. Prices not only vary from dealer to dealer, but some dealers charge different prices to different customers for the exact same product—even for the exact same product, with the same dealer cost, purchased on the same day.

The practice of charging different prices to consumers for the same product that costs the dealer the same amount can lead to discrimination. Our analysis finds that dealers, on average, marked up service contracts more when selling to Hispanics than to non-Hispanic buyers. It is likely that a greater disparity would be revealed if we could compare Hispanics to non-Hispanic whites or if we could measure pricing differences between whites and blacks or other minority groups. Since these differences appear in the retail pricing of add-on products, which are not determined by credit scores, they cannot be explained by differences in buyers' credit scores.

Add-on pricing practices are largely within the discretion of individual dealers, but banks, credit unions, and finance companies that finance vehicle purchases for consumers can and do limit the size of add-on markups. Our analysis shows that some creditors place firmer limits on dealers than others.

The following recommendations, if implemented, would help protect car buyers from the abuses described in the report.

- **Dealers should be required to post the available add-ons and their prices on each car in the lot, along with the price of the car.** To prevent the dealer from reintroducing non-transparency by offering discounts to some customers but not others, the prices for the add-on products must be non-negotiable.
- **To root out pricing discrimination, the federal Equal Credit Opportunity Act regulations should be amended to require documentation of the customer's race or national origin** for non-mortgage credit transactions, as is currently required for home mortgage transactions. If discrimination remains hidden, it will not be possible to end it.
- **State and federal enforcement authorities should investigate discrimination in pricing of add-on products and bring enforcement actions** against a dealer if discrimination is shown. The Consumer Financial Protection Bureau, the Federal Trade Commission, the Federal Reserve Board, and state attorneys general all have authority in this area.

APPENDIX
**THE DATA USED FOR ANALYSIS
IN THIS REPORT**

Add-on Data

This analysis is based on data regarding the sale of vehicle add-on products from one major add-on provider from September 2009 through June 2015. The data set includes information from approximately 1.8 million car sale transactions, resulting in the sale of almost three million add-on products, spanning over 3,000 car dealers from every state and the District of Columbia.

The data set includes transaction-level information about the sale of individual add-on products during this time period. The process of converting the data to a format that could be analyzed using statistical analysis programs involved some random data loss, which we estimate at approximately 5% of the original data set.

We were able to verify the accuracy of individual data points through several sources including litigation, newspaper articles, bankruptcy filings, and other independent sources. Our review of the data did reveal a very small number of customer charges that we believe to be potentially inaccurate, likely resulting from error in the original entry of sale information at the dealership. We believe at least some of these isolated outliers may be due to the failure to include a decimal point at the time of the data entry. The number of potentially inaccurate customer charges was small enough not to alter our conclusions, but in order to avoid overstating the markups, we treated all instances where customer charges for add-on products were greater than \$10,000 as errors and excluded them. Extensive spot-checking of transactions with a consumer charge above and below \$10,000 suggests that this is a conservative threshold.

We also excluded transactions regarding add-ons for recreational vehicles and for transactions outside the United States.

Lienholder and Other Data for Ohio

The Ohio Department of Public Safety maintains a public website for car title information. The site is publicly searchable based on Vehicle Identification Number (VIN). The website provides information including total purchase price, title issue date, and sometimes lienholder information.

This Department posts this information for the most recent transaction involving a particular car. For example, if a car was sold as a new car in Ohio, and then later sold as a used car, the Department's website will show more detailed information for only the later sale. Using this website, we were able to obtain information regarding the vehicle sale transactions from a number of Ohio transactions by matching the VIN and the Ohio

title issue date when the title issue date was within 60 days after the sale date found in the add-on data. Using this process we were able to identify the lienholder information for over 23,000 Ohio transactions for the years analyzed in this report.

Rounding

Throughout this report we rounded monetary amounts to the nearest dollar.

ENDNOTES

1. The facts we describe come from the pleadings and briefings filed in this matter.
2. Raj Chetty and Nathaniel Hendren, *The Impacts of Neighborhoods on Intergenerational Mobility: Childhood Exposure Effects and County-Level Estimates*, Harvard University and NBER May 2015, available at http://scholar.harvard.edu/files/hendren/files/nbhds_paper.pdf.
3. See, Elizabeth Roberto, *Commuting to Opportunity: The Working Poor and Commuting in the United State*, Brookings Institute, February, 2008, available at https://www.brookings.edu/wp-content/uploads/2016/06/0314_transportation_puentes.pdf.
4. National Consumer Law Center, "New Ways to Understand the Impact of Auto Finance on Low-Income Families," available at http://www.nclc.org/images/pdf/car_sales/ibImportance_AutoFinanceFINAL53116.pdf.
5. Raj Date and Brian Reed, "AUTO RACE TO THE BOTTOM: Free Markets and Consumer Protection in Auto Finance," Cambridge Winter, November 16, 2009.
6. Delvin Davis and Joshua M. Frank, "UNDER THE HOOD: Auto Loan Interest Rate Hikes Inflate Consumer Costs and Loan Losses," Center for Responsible Lending, April 19, 2011, available at <http://www.responsiblelending.org/other-consumer-loans/auto-financing/research-analysis/Under-the-Hood-Auto-Dealer-Rate-Markups.pdf>.
7. For more information see: <https://www.nclc.org/litigation/case-index-closed-cases.html#auto>.
8. See e.g., Ian Ayers, Expert Report, June 2004, available at <http://www.consumerlaw.org/issues/cocounseling/content/AHFClanAyersReportExhibits.pdf>.
9. Cohen, Mark A. "Imperfect Competition in Auto Lending: Subjective Markups, Racial Disparity, and Class Action Litigation." Available at <http://ssrn.com/abstract=951827>.
10. See CFPB Bulletin at <http://www.consumerfinance.gov/about-us/newsroom/consumer-financial-protection-bureau-to-hold-auto-lenders-accountable-for-illegal-discriminatory-markup/>. AutoNation Continues Living Above \$1,600 Per-Copy in Q3, F&I and Showroom, November 1, 2016.
11. AutoNation Continues Living Above \$1,600 Per-Copy in Q3, F&I and Showroom, November 1, 2016.
12. Group 1 Automotive Chooses Margin Over Volume in Q3, F&I and Showroom, October 26, 2016.
13. See, e.g. Hannah Lutz, "Sales of Service Contracts and F&I add-ons Critical," *Automotive News*, December 14, 2015, available at http://www.autonews.com/article/20151214/FINANCE_AND_INSURANCE/312149986/sales-of-service-contracts-and-f%26i-add-ons-critical (citing data from one product provider showing that dealer profit from add-on sales constituted 63% of total F&I profit for its dealer customers).
14. "More Car Shoppers Are Underwater on Their Trade-Ins Than Ever Before," *Edmonds*, November 14, 2016, available at <https://www.edmunds.com/about/press/more-car-shoppers-are-underwater-on-their-trade-ins-than-ever-before-reports-edmundscom.html> (noting that, in 2016, 32% of consumers buying new cars had trade-ins on which they owed more than the car was worth, on average \$4,832 more and 25% of consumers buying used cars had trade-ins on which they owed more than the car was worth by an average of \$3,635).
15. See the discussion of why creditors finance vehicles for more than they are worth in the section "How Auto Creditors Affect Pricing" below.
16. *F&I Best Practices and Performance Metrics*, Zurich American Insurance Company, 2012.
17. See Jamie LaReau, "Preloading products boosts per-car F&I sales," *Automotive News*, December 26, 2012.
18. Dealers track their penetration rate or the number of a particular add-on they sell as a

portion of their overall vehicle sales or some subset of their overall vehicle sales. Some dealers exclude particular types of transactions such as fleet sales or cash sales from the calculation of their penetration rate.

19. *State of the Industry Report 2012*, NADA p.10; see also Gregory Arroyo, "Tracking F&I Performance, F&I and Showroom," January 2012.
20. "Tracking F&I Performance," F&I and Showroom available at <http://www.fi-magazine.com>
21. "Zurich Elite Performance Account Benchmarks 2012," cited in *F&I Best Practices and Performance Metrics*, Zurich American Insurance Company, 2012.
22. The increase in the retail price over the wholesale price can be expressed either as a markup or as a margin. Markup is the ratio of gross profit to the wholesale price while margin is a ratio of gross profit to the retail price. For example, a product that costs a retailer \$4 may be sold for \$5. The \$1 by which the retail price exceeds the wholesale price can be expressed as a 25% markup or a 20% margin. Throughout this report we use markup percentages. Where our source expressed the percentage as a margin, we have converted it to a markup.
23. Alsın, Arne "Retail markups and the power of Amazon" Marketwatch.com, Sept. 15, 2012, available at <http://blogs.marketwatch.com/great-columnist/2012/10/15/retail-markups-and-the-power-of-amazon>
24. Ian Johnston, "What Is the Percent of Profit Margin That Retailers Expect From Jewelry?," *Houston Chronicle*, available at <http://smallbusiness.chron.com/percent-profit-margin-retailers-expect-jewelry-73996.html>.
25. AnnaMaria Andriotis, 10 Things Furniture Stores Won't Tell You, Marketwatch.com, Feb 4, 2011, available at <http://www.marketwatch.com/story/10-things-furniture-stores-wont-tell-you-1296850666159>
26. See *Understanding the Grocery Industry* The Reinvestment Fund, Sept 30, 2011, available at https://www.cdfifund.gov/Documents/Understanding%20Grocery%20Industry_for%20fund_102411.pdf; See also Walter Johnson, "The Industry Standard for Gross Margin in Groceries" available at <http://smallbusiness.chron.com/industry-standard-gross-margin-groceries-38121.html>
27. Arne Alsın, "Retail markups and the power of Amazon" Marketwatch.com, Sept. 15, 2012, available at <http://blogs.marketwatch.com/great-columnist/2012/10/15/retail-markups-and-the-power-of-amazon/>
28. Doug DeMuro, "Buying a Car: How Much Do Dealers Mark Up a Car Over the Invoice Price?," *Autotrader*, August 2014, available at <http://www.autotrader.com/car-news/buying-a-car-how-much-do-dealers-mark-up-a-car-over-the-invoice-price-228247>.
29. See *How The Auto Industry has Disguised Dealer Incentive Dollars as Dealer Cost Dollars by Moving Them From the Msrp/Sticker Price Into the Invoice Price for Over 18 Years*, available at <http://fightingchance.com/addon04.php>.
30. National Automobile Dealers Association (NADA) Data 2015 *Annual Financial Profile Of America's Franchised New Car Dealerships*, available at <https://www.nada.org/WorkArea/DownloadAsset.aspx?id=21474839497>. The study found a gross margin of 3.3% for new cars and 7.9% for used cars, which are the mathematical equivalent of markups of 3.4% and 8.6%, respectively. See footnote 24 explaining the difference between margin and markup.
31. An 8.6% markup for used cars is lower than the markup suggested by the typical percentage difference between the wholesale or trade-in price for a car found in a standard pricing guide and the retail price listed in the guide for the car. For example, in early 2017, the trade-in value of a base model 2012 Honda Accord with 60,000 miles in good condition is \$7,960, according to the Kelly Blue Book. For the same vehicle, the "Fair Purchase Price" from a dealer is listed as \$11,697. This would be a gross markup of \$3,737 or 47 percent. For dealers

selling used cars that they have taken in as a trade-in, the trade-in amount they gave the consumer plus their costs in preparing the car for resale would be the wholesale cost for the car when they sell it to a new consumer. Accordingly, using the example above, the true markup on the car would be less than 47% as there would be some costs to the dealer to prepare the trade-in vehicle for retail sale. Dealers may also attribute some of the difference between the acquisition cost at trade-in and the retail sale to a subsequent customer as a gain on the trade-in transaction, from acquiring the trade-in at a low price, rather than as part of the markup on the subsequent sale.

32. Many add-on products were previously regulated as insurance, but in recent years the industry has obtained legislation in a number of states to exempt them from insurance regulation.
33. Nevertheless, the person selling the insurance may have discretion as to which insurance company's policy or which specific policy of an insurer will be sold to a specific individual.
34. See Julia Angwin, "California to Investigate Racial Discrimination in Auto Insurance Premiums," *ProPublica*, May 19, 2017, available at <https://www.propublica.org/article/california-to-investigate-racial-discrimination-in-auto-insurance-premiums>, and Douglas Heller and Michelle Styczynski, *Major Auto Insurers Raise Rates Based on Economic Factors* Consumer Federation of America, June 2016 (detailing how low-income drivers are charged higher premiums than those with higher incomes based upon economic factors that are unrelated to driving safety), available at http://consumerfed.org/wp-content/uploads/2016/06/6-27-16-Auto-Insurance-and-Economic-Status_Report.pdf.
35. See Nolan Hester, "How much is your insurance agent making off you?," *Insure.com*, April 2, 2010, available at <http://www.insure.com/car-insurance/insurance-agent-commissions.html>, quoting Wesley Bissett of the Independent Insurance Agents & Brokers of America (IIABA).
36. Technically, the loss ratio used for evaluating rates is incurred claims divided by earned premiums.
37. See National Association of Insurance Commissioners Report on Profitability By Line By State, IEE Percent of Direct Premiums Earned Losses Incurred, http://www.naic.org/prod_serv/PBL-PB-16.pdf.
38. *F&I Showroom*, Volume 14, Issue 9, September 2011, p. 31.
39. This number may be slightly low in that certain claims have yet to be paid on the policies reflecting the \$5 billion in dealer profit.
40. Insurance rates are calculated based on claims, claim settlement expenses, selling expenses, general and administrative expenses, and profit. We only know two elements from the advertisement—claims (\$600 million) and selling expenses (\$5 billion in profits paid to car dealers), so the total paid by consumers will be significantly more than \$5.6 billion. Even if no insurance company is involved in the provision of these products, there must be some administrative expenses for tracking sales and claims, and the seller is surely intending to make a profit.
41. See Credit Life Insurance and Credit Accident & Health Insurance Experience 2011-2015, National Association of Insurance Commissioners, 2016 available at http://www.naic.org/prod_serv/CRE-ZB-17.pdf (showing that, from 2005 through 2014, annual credit life insurance loss ratios ranged from 41.5% to 47.7% and credit life loss ratios from 34.93% to 45.23%).
42. National Consumer Law Center, *Consumer Credit Regulation* § 6.2.3.1 (2d ed. 2015), updated at www.nclc.org/library (including charts compiled by Birny Birnbaum, Center for Economic Justice, from Credit Insurance Experience Exhibit (CIEE) to Statutory Annual Statements submitted by insurers to the National Association of Insurance Commissioners (NAIC)).
43. CONSUMER CREDIT INSURANCE MODEL REGULATION, 1994 National Association of Insurance Commissioners, § 5, available at <http://www.naic.org/store/free/MDL-370.pdf>. The drafters suggested that once a 60% loss ratio had been implemented the cap on compensation

- might no longer be needed.
44. The average pay for an F&I manager in 2012 was \$128,400. 2013 NADA Dealership Workforce Study Industry Report.
 45. Jamie LaReau, "Group's F&I mantra: Sell big or bow out, If managers miss targets, trained replacements wait in the wings," *Automotive News* July 8, 2013, quoting Steve VanGorder.
 46. Jamie LaReau, "Group's F&I mantra: Sell big or bow out, If managers miss targets, trained replacements wait in the wings," *Automotive News* July 8, 2013, quoting Steve VanGorder.
 47. Mark Gokavi, "Jeff Schmitt Auto Group accused of 'deceptive' business practices," *Dayton Daily News*, August 5, 2013.
 48. Mark Gokavi, "Jeff Schmitt Auto Group accused of 'deceptive' business practices," *Dayton Daily News*, August 5, 2013, stating that "The Ohio Attorney General's Office logged 24 complaints against the Jeff Schmitt Auto Group from Jan. 1, 2012 to April 2013. These complaints are recorded independently of any lawsuits. Only one other area dealer came close with 17 complaints. Most dealers had zero to one complaint each."
 49. Gil Van Over, "Pricing Guidelines for Fun and Profit," *Dealer Magazine*, July 2010.
 50. Ronald Reahard, "10 More Ways To Help Your Dealers Sell More Products," *Agent Entrepreneur Magazine*, January 19, 2012.
 51. The cause for these variations from dealer to dealer is not always clear but may reflect additional commissions given to agents who sometimes act as middlemen between the dealer and the add-on provider. It could also reflect volume pricing.
 52. See, e.g., Ian Ayers, Expert Report, June 2004, available at <http://www.consumerlaw.org/issues/cocounseling/content/AHFCIanAyersReportExhibits.pdf>; Cohen, Mark A. "Imperfect Competition in Auto Lending: Subjective Markups, Racial Disparity, and Class Action Litigation." Available at <http://ssrn.com/abstract=951827>; and CFPB enforcement activities at <http://www.consumerfinance.gov/about-us/newsroom/consumer-financial-protection-bureau-to-hold-auto-lenders-accountable-for-illegal-discriminatory-markup/>. See also Delvin Davis, *Non-Negotiable: Negotiation Doesn't Help African Americans and Latinos on Dealer-Financed Car Loans*, Center for Responsible Lending, January 2014, available at <http://www.responsiblelending.org/other-consumer-loans/auto-financing/research-analysis/CRL-Auto-Non-Neg-Report.pdf> (documenting self-reinforcing nature of discriminatory pricing: If minority customers are charged higher prices at many dealers, then F&I managers may have less reason to negotiate with them as they may be forced to accept higher prices out of necessity).
 53. 12 C.F.R. § 1002.5(b), 12 C.F.R. § 1002.12(a), (b).
 54. "It is the purpose of this Act to require that financial institutions and other firms engaged in the extension of credit make that credit equally available to all creditworthy customers without regard to [sex, marital status, race, religion, national origin and age]." Equal Credit Opportunity Act, Pub. L. No. 93-495, § 502, 88 Stat. 1521, 1521 (1974).
 55. U.S. Government Accountability Office, *Fair Lending: Race and Gender Data Are Limited for Nonmortgage Lending*, GAO-08-698 (June 2008).
 56. See "Using publicly available information to proxy for unidentified race and ethnicity, A methodology and assessment," Consumer Financial Protection Bureau, Summer 2014, available at http://files.consumerfinance.gov/t/201409_cfpb_report_proxy-methodology.pdf (describing the use of Bayesian Improved Surname Geocoding).
 57. <https://consumercomplianceoutlook.org/outlook-live/2013/indirect-auto-lending/>
 58. Both the CFPB's analysis and industry-sponsored critiques of the CFPB's analysis find that surname analysis alone without geocoding is much better suited for creation of a proxy for Hispanics than for African Americans. See "Using publicly available information to proxy for unidentified race and ethnicity, A methodology and assessment," Consumer Financial

- Protection Bureau, Summer 2014, available at http://files.consumerfinance.gov/f/201409_cfpb_report_proxy-methodology.pdf and Arthur P. Baines and Dr. Marsha J. Courchane, *Fair Lending: Implications for the Indirect Auto Finance Market*, Charles River Associates, November 19, 2014, prepared for the American Financial Services Association, available at <https://www.crai.com/sites/default/files/publications/Fair-Lending-Implications-for-the-Indirect-Auto-Finance-Market.pdf>.
59. See Mark A. Cohen, Ph.D., *Report on the Racial Impact of AHFC's Finance Charge Markup Policy*, June 30, 2004, available at <https://www.nclc.org/images/pdf/litigation/closed/ahfc-cohenreportappendices-a-c.pdf>.
 60. While our data is arguably a "complete" population of transactions for which we arguably might not need to test for sampling error since it comes from one add-on provider over a number of years, a number of factors led us to treat the data otherwise. Due to possible limitations of our data set, we cannot confirm with certainty that this is the complete set of data from the single provider, and in any case it is only a portion of the larger third party add-on market. Additionally we were looking only at data from one period of time, which could be considered a sample of add-on pricing data over a longer period. Even if the data was considered a complete population, we wanted to avoid the possibility that the effects we were seeing were the result of simple random chance.
 61. We only looked at the states where the p-values were less than .05, an almost universally accepted standard for statistical significance.
 62. See Mark A. Cohen, Ph.D., *Report on the Racial Impact of AHFC's Finance Charge Markup Policy*, June 30, 2004, available at <https://www.nclc.org/images/pdf/litigation/closed/ahfc-cohenreportappendices-a-c.pdf>.
 63. Based upon demographic data from Population Distribution by Race/Ethnicity | The Henry J. Kaiser Family Foundation Timeframe: 2015, available at <http://www.kff.org/other/state-indicator/distribution-by-raceethnicity/?currentTimeframe=0&sortModel=%7B%22colId%22:%22Location%22,%22sort%22:%22asc%22%7D>. The average percentages we state are the unweighted averages. In other words, these percentages represent the average of the percentages in all the specific states without weighting them for population. For the 34 states for which only one or neither measure was statistically significant, the African American population averaged 11.25% while the Hispanic population averaged 9.94%. For the 14 states for which the differences in both percentage and absolute markup which were statistically significant, the Hispanic population averaged 17.5% while the African American population averaged 9.71%.
 64. The possibility of dealerships charging a particular minority a lower amount is not unheard of. See the Justice Department's Settlement of alleged auto lending discrimination in the case of Union Auto Sales, Inc., where the dealer allegedly charged higher interest rate markups on car loans to non-Asians than to similarly-situated Asians. See: <https://www.justice.gov/opa/pr/justice-department-settles-lawsuit-alleging-auto-lending-discrimination-los-angeles>.
 65. David Segal, "The New Car With Mystery Add-Ons," *The New York Times*, Dec. 25, 2010 (describing how a consumer did not receive a refund for add-ons despite the dealer having received a check for a portion of the add-on from the add-on company), available at <http://www.nytimes.com/2010/12/26/your-money/26haggler.html>. Refunds for canceled contracts are calculated under several different formulas, which are sometimes dictated by state regulation. See, e.g., Cal. Civ. Code § 1794.41. For a helpful discussion of California cancellation rebates and other service contract related issues see The California Insurance Commissioner's Guide to Automobile Service Contracts, Extended Warranties and Other Repair Agreements,

- available at <http://www.insurance.ca.gov/01-consumers/105-type/95-guides/01-auto/servcontextwar.cfm>. Because the majority of the price paid by the consumer goes to the dealer and not the add-on supplier, the add-on company cannot refund consumers directly if a consumer cancels a contract. Instead, the add-on supplier will give the dealer a refund of a portion of the amount that the dealer paid it for the add-on product, with the calculation based on the rebate formula. Then the dealer is the entity that is tasked with refunding the money to the consumer. For this reason, add-on companies track consumer prices even though they are not generally involved in the setting of prices.
66. Understanding automotive loan charge-off patterns can help mitigate lender risk, Experian Information Solutions, 2012, (finding high loan-to-value ratios predictive of potential charge-offs) available at <http://www.experian.com/assets/consumer-information/white-papers/auto-vision-wp.pdf>
 67. See CFPB Bulletin at <http://www.consumerfinance.gov/about-us/newsroom/consumer-financial-protection-bureau-to-hold-auto-lenders-accountable-for-illegal-discriminatory-markup/>.
 68. See Natalie Mattila, "Subprime Competition Prompts Pricing Pressures, S&P Says" *Auto Finance News*, September 20, 2016, available at <http://www.autofinancenews.net/subprime-competition-prompts-pricing-pressures-sp-says/>, also see Jon Marino, "Auto Financing: Wall Street is Turning Out More Car Loans" CNBC, July 15, 2016, available at <http://www.cnbc.com/2016/07/15/auto-financing-wall-street-is-turning-out-more-car-loans.html>.
 69. Semiannual Risk Perspective, Comptroller of the Currency, National Risk Committee, Spring, 2015, available at <https://www.occ.gov/publications/publications-by-type/other-publications-reports/semiannual-risk-perspective/semiannual-risk-perspective-spring-2015.pdf> ("In the fourth quarter of 2014, the average LTV for used vehicle auto loans was 137 percent. Moreover, advance rates for borrowers across the credit spectrum are trending up, with used vehicle LTVs for subprime borrowers (credit score < 620) averaging nearly 150% at the end of 2014. Sales of add-on products such as maintenance agreements, extended warranties, and gap insurance are often financed at origination. These add-on products in combination with debt rolled over from existing auto loans contribute to the aggressive advance rates.").
 70. We obtained lienholder data for over 23,000 Ohio transactions. Over 9,500 of these transactions involved the sale of GAP. 280 had a consumer price for GAP over \$900.00. (See Appendix for details).
 71. N.Y.C. Admin. Code § 20-271 (Local Laws of the City of New York for the Year 2015, No. 44).
 72. 12 C.F.R. § 1002.5(b), 12 C.F.R. § 1002.12(b).
 73. 12 C.F.R. § 1003.4(a).
 74. Creditors may obtain permission to collect race or ethnic data in limited circumstances for self-testing but it is seldom done.
 75. "It is the purpose of this Act to require that financial institutions and other firms engaged in the extension of credit make that credit equally available to all creditworthy customers without regard to [sex, marital status, race, religion, national origin and age]." Equal Credit Opportunity Act, Pub. L. No. 93-495, 5 502, 88 Stat. 1521, 1521 (1974).
 76. U.S. Government Accountability Office, *Fair Lending: Race and Gender Data Are Limited for Nonmortgage Lending*, GAO-08-698 (June 2008).
 77. In the late 1990s the Federal Reserve Board, partly in response to comments by the Department of Justice and the federal financial enforcement agencies, proposed removing the prohibition on seeking information about an applicant's race, color, religion, national origin, and sex for non-mortgage credit products. 64 Fed. Reg. 44,582, 44,586 (Aug. 16, 1999).



**New Ways to Understand the
Impact of Auto Finance on
Low-Income Families**

May 2016

Conventional analysis of auto finance tends to ignore the number of families affected and their demographics. It also tends to obscure the rate at which new car financings are originated in comparison to other consumer debt. While economists, policymakers, and others realize the overall role that auto finance plays in the United States' financial landscape, the scale of the impact of auto finance on those with low and moderate income, people of color, and younger people has received less attention. This report looks at existing data in new ways to better understand the true scale of auto finance for low- and moderate-income families.

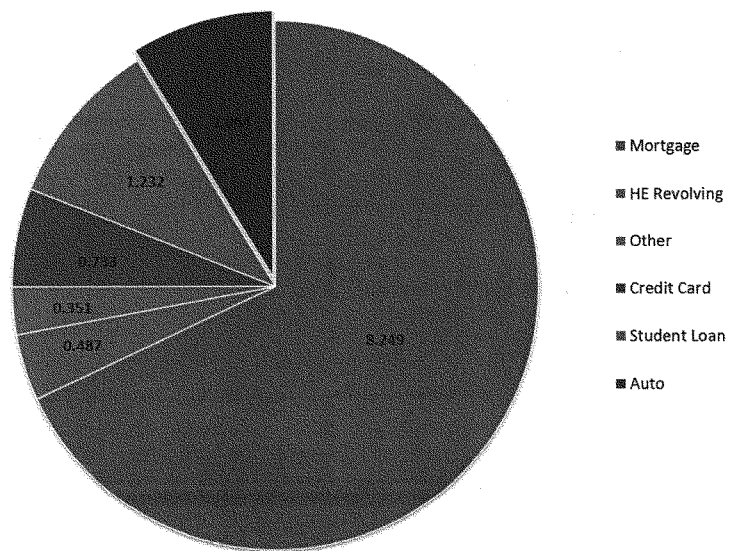
Most decision makers, when trying to understand the role of auto finance in the economy and the extent to which it affects households and particular populations, look at data regarding the total outstanding balance of auto finance. Often this debt is examined in comparison to other large and important consumer finance categories, typically mortgage loans, student loans, and credit card debt.

Delving deeper into publicly available data allows for new insight into the prevalence of auto debt and the extent to which it weighs on vulnerable consumers, particularly low- and moderate-income families.

Conventional Analysis

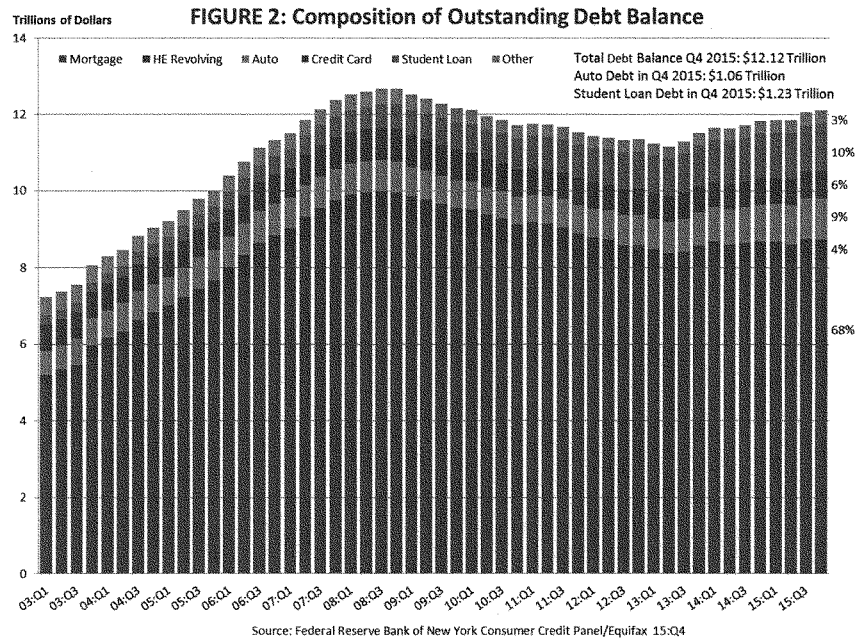
Data from the fourth quarter of 2015 shows that, by dollar volume, the vast majority of the consumer debt in the United States is mortgage debt. A small but significant portion of the total debt is comprised of student loans and auto finance. Total outstanding mortgages account for \$8.24 trillion compared to \$1.23 trillion for student loans and \$1.06 trillion for autos (Figure 1).

FIGURE 1: Total Debt Balance Q4 2015 in Trillions of Dollars



Source: Federal Reserve Bank of New York Consumer Credit Panel/Equifax 15:Q4

The dynamic movement of these aggregate outstanding balances over time is also often monitored. Consequently, the increasing significance of auto and student loan debt on overall debt is regularly reported. (Figure 2).

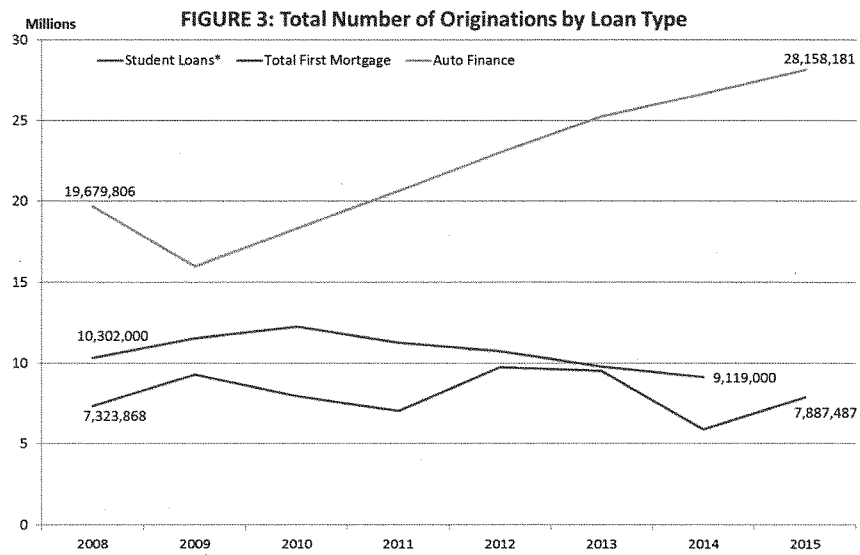


Deeper Analysis Including the Number of Families Affected and Their Economic Condition

While understanding the scale by dollar volume and the change in outstanding debt for these categories over time is helpful, there is much more to learn. Unfortunately, this is the point at which analysis often stops. These broad analyses paint an incomplete picture, ignoring both the number of consumers and new financing transactions represented by this data. Consequently, interested parties, especially industry actors and policymakers working towards the economic success of low- and moderate-income families, must look deeper.

From a perspective of family economic success, understanding the number of consumers affected by auto financing is critical. A large amount of total debt in one category owed by a smaller number of families may overshadow a smaller outstanding total debt owed by a much larger number of families. The extent of origination of new debt is also important to understand because origination is typically the point at which many abuses occur. While consumers will pay for these abuses over the life of the loan, each new financing event represents an opportunity—a time when consumers may either be saddled with new abuses or avoid unnecessary costs.

Reviewing the number of new originations rather than just the outstanding debt in dollars provides insight into how often new credit transactions occur and an approximation of how many families are affected in a given period (Figure 3). For example, in 2014 (the most recent year for which student loan data is available) there were almost three times as many families originating auto finance as borrowers originating student loans, and more than three times the number of auto finance originations as mortgage originations.



Source: Federal Reserve Bank of New York Consumer Credit Panel 15:Q4; Equifax U.S. Consumer Trends, February 11, 2016; Federal Reserve Bank of New York, Student Loan Borrowing and Repayment Trends, 2015 (student loan data through 2014)

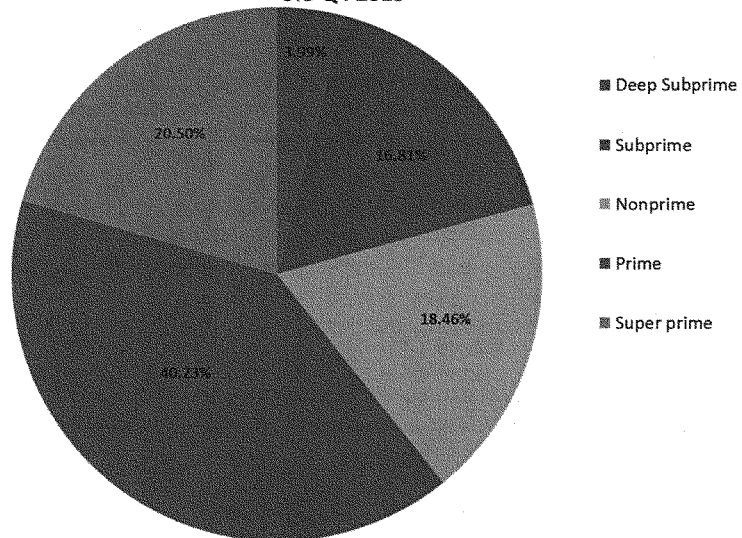
* The student loan data represents the number of borrowers originating student loans during a given year.

Further analysis provides even more insight regarding the importance of auto finance on families of color and low-and moderate-income families. Data showing auto originations by race is not available and data by family income is not publicly available. However, there is data for both mortgage and auto finance by consumer credit score. Because credit scores have a strong correlation with race¹ and a correlation with income, in addition to correlations with educational attainment and other characteristics,² this data can help us understand the demographics of families who finance car purchases. This data should be of particular interest to policymakers and advocates, since those with low credit scores may be more vulnerable to abusive practices. Consumers with Experian credit scores classified as Prime (the best credit score) make up the largest individual cohort of those financing cars. Yet, collectively, consumers with lower credit scores, labeled as Nonprime, Subprime, and Deep Sub Prime, represent about 30% of open auto finance (Figure 4).

¹ See National Consumer Law Center, *Past Imperfect: How Credit Scores and Other Analytics “Bake In” and Perpetuate Past Discrimination* (May 2016) available at: http://www.nclc.org/images/pdf/credit_discrimination/Past_Imperfect050616.pdf.

² See Newman, Anna E. & Newman, Joseph A., The Demographic Impact on Credit Scores: Evidence From Statistical Methods and Geographic Information Systems (GIS) Mapping, *Journal of Modern Accounting and Auditing*, November 2013, Vol. 9, No. 11, 1497-1506

FIGURE 4: Percentage of Open Auto Finance by Experian VantageScore® 3.0 Q4 2015

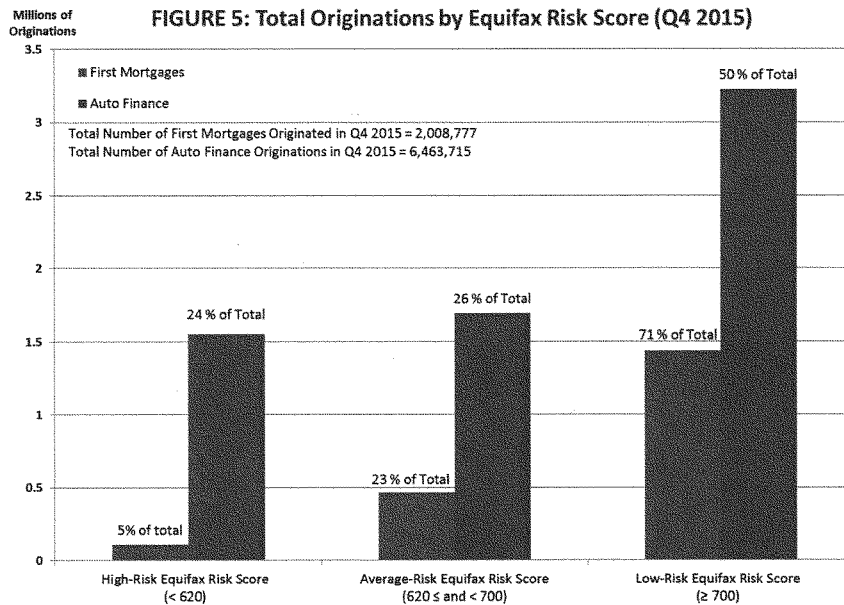


Source: Experian, State of the Automotive Finance Market, Fourth Quarter 2015

Credit score categories are based on the following Experian VantageScore® 3.0 ranges:

Super Prime = 781-850; Prime = 661-780; Nonprime = 601-660; Subprime = 501-600; Deep Subprime = 300-500

Comparing mortgage and auto originations, those with “High-Risk” Equifax scores originated nearly 25% of auto finance transactions, but just 5% of mortgage transactions. There were about 2 million (2,008,777) total mortgage originations in that period and nearly 6.5 million (6,463,715) auto originations. This means that of struggling consumers with “High-Risk” scores, more than 1.5 million (1,551,292), bought and financed a car while just 100,439 financed a house (Figure 5).



Source: Equifax, U.S. Consumer Trends, February 11, 2016

Conclusion

Digging deeper into available data helps policymakers and advocates to better understand the true impact of auto finance, and government policy, on low- to moderate-income families. Moving away from the idea of dollars of debt outstanding to an appreciation of the huge number of struggling families that finance a car purchase puts into sharp focus the importance of policies that create and foster a fair and transparent market for auto finance.

For more information, contact John Van Alst (jvanalst@nclc.org) or Yael Shavit (yshavit@nclc.org).



Since 1969, the nonprofit National Consumer Law Center® (NCLC®) has worked for consumer justice and economic security for low-income and other disadvantaged people, including older adults, in the U.S. through its expertise in policy analysis and advocacy, publications, litigation, expert witness services, and training. www.nclc.org

**The National Association of Insurance Commissioners
Statement for the Record**

**House Financial Services Subcommittee on Oversight and Investigations
Hearing on
Examining Discrimination in the Automobile Loan and Insurance Industries**

May 1, 2019

On behalf of the primary regulators of the U.S. insurance sector, the National Association of Insurance Commissioners (NAIC)¹ appreciates the opportunity to submit this written statement. We appreciate the Subcommittee's interest and attention to this important issue. Addressing unfair treatment of insurance consumers is central to the work we do and a responsibility we take seriously.

Insurance regulators have robust authority to address potential instances of unfair treatment of consumers, including those related to protected classes. Specifically, insurance regulators have authorities to address discriminatory practices in underwriting and ratemaking. Insurance companies use rating factors that are correlated with the risks of the insurance policyholder in order to set actuarially sound pricing. This process involves insurance companies establishing risk classifications to differentiate insurance consumers who will experience different levels of expected loss. However, the state insurance regulatory framework recognizes that certain risk classifications, even when accurately correlated with risk and effective from a purely actuarial perspective, may be inconsistent with public policy and therefore specifically provides regulators the authority to ensure that rates are not "excessive, inadequate, or unfairly discriminatory."² This authority is intentionally broad and designed to ensure that certain characteristics are not used to set rates. In addition, states have significant authority under their unfair trade practice statutes to address other types of discriminatory practices. These statutes, based on the NAIC *Unfair Trade Practices Model Act*, prohibit insurers from refusing to insure, refusing to continue to insure, or limiting the amount of coverage available to an individual because of race, sex, marital status, religion or national origin.³

To help implement these statutory authorities, state insurance regulators have tools designed to identify problematic activity. With the exception of Illinois, all states have rate approval processes either through a "prior approval process" or a "file and use" process.⁴ The NAIC Market Regulation Handbook also contains standards for the examination of unfair discrimination in underwriting and rating. Among other review procedures, the Handbook sets forth guidance for the review of relevant underwriting information to ensure that no unfair discrimination is occurring. The regulated entity must have underwriting guidelines that conform to state laws, must follow them consistently and must not treat protected classes of individuals unfairly. Regulators are advised that inconsistent handling of rating or underwriting

¹ Founded in 1871, the NAIC is the U.S. standard-setting and regulatory support organization created and governed by the chief insurance regulators from the 50 states, the District of Columbia and the five U.S. territories. Through the NAIC, state insurance regulators establish standards and best practices, conduct peer review, and coordinate their regulatory oversight. NAIC members, together with the central resources of the NAIC, form the national system of state-based insurance regulation in the U.S.

² Section 4.A of NAIC *Property and Casualty Model Rating Law* (Prior Approval Version) and Section 5.A of NAIC *Property and Casualty Model Rating Law* (File and Use Version).

³ Section 4.G(5) of the NAIC *Unfair Trade Practices Act*.

⁴ Some states have a "use and file" framework. The "file and use" and "use and file" are similar in terms of regulatory oversight. Illinois is the only state that does not have a rate approval process.

practices, even if not intentional, can result in unfair discrimination, including requests for supplemental information. According to NAIC data, from 2007 to 2018, states conducted 523 examinations pertaining to “underwriting discrimination,” “rating discrimination,” or “use of prohibited rating factors.” State regulators found 51 instances where 32 different companies were non-compliant and took action accordingly.⁵

Moreover, state regulators recently enhanced their toolkit specifically as it relates to auto insurance by collecting ZIP Code level data from statistical agents. All states now have access to the data in a tool that takes the 12 million plus records and makes them easier to analyze. Regulators can select a region, city, or ZIP Code and look at coverage type and see the average premium, frequency, severity and losses in that area. They can also pull in a demographic area and look at metrics like average income in that ZIP, etc. If states see anomalies or reason for concern including potential instances of unfair discrimination, they can follow up and look at individual company data. The NAIC is also completing a public report that will show maps at a ZIP Code level in every state for the same metrics. The report will show income quantiles in order to exhibit average premiums, frequency and severity for each. This will provide additional data to regulators at a more granular level in order to understand low-income populations so they may better evaluate risk assessment by insurers.

While insurance regulators currently have broad authorities to address unfair treatment of consumers, we also acknowledge that insurance rating and underwriting have become increasingly more complex with the advent of complex algorithms and emerging use of artificial intelligence. Though technological advancements have the propensity to more accurately price insurance products for individuals with varying risks, which can reduce costs and benefit consumers, state insurance regulators have recognized the complexity of these processes and the need to ensure they comply with state insurance laws and regulations designed to protect consumers from illegal practices. To that end, state insurance regulators, through the NAIC, have been exploring insurers’ use of big data for claims, marketing, underwriting and pricing to encourage innovation while maintaining appropriate consumer protections. One of the current work streams is a proposal to explore options for helping regulators review complex models used in support of auto and homeowner insurance rate filings. We recently broadened our focus to explore the use of data for underwriting life insurance products and state market conduct examination practices for the review of life insurance underwriting. Future discussions will turn toward the use of data and models for claims settlement and fraud detection.

In conclusion, state insurance regulators appreciate the work of the Oversight and Investigations Subcommittee to explore issues of discrimination in auto insurance. Preventing unfair behavior is central to regulators’ core mission of consumer protection and we remain committed to continuing to address this important issue through our supervision of the insurance sector. Thank you for allowing us the opportunity to provide this statement for the record.

⁵ This is based on data voluntarily submitted by member jurisdictions to the NAIC. States maintain their own data relating to examinations, rate filing reviews and specific enforcement actions.



Statement
of the
National Association of Mutual Insurance Companies
to the
United States House of Representatives
Committee on Financial Services
Subcommittee on Oversight and Investigations
Hearing on
“Examining Discrimination in the Automobile Loan and Insurance
Industries”
Rayburn House Office Building
May 1, 2019

The National Association of Mutual Insurance Companies is respectfully offering this statement to the United States House of Representatives Committee on Financial Services Subcommittee on Subcommittee on Oversight and Investigations for its Hearing on “Examining Discrimination in the Automobile Loan and Insurance Industries.”

NAMIC is the oldest property/casualty insurance trade association in the country, with more than 1,400-member companies representing 41 percent of the total market. NAMIC supports regional and local mutual insurance companies on main streets across America and many of the country’s largest national insurers. NAMIC member companies serve more than 170 million policyholders and write more than \$230 billion in annual premiums. Our members account for 54 percent of homeowners, 47 percent of automobile, and 32 percent of the business insurance markets.

Insurance Scores and Auto Insurance

Insurance scores (also called “credit-based insurance scores”) are confidential numerical ratings based in whole or in part on a consumer’s credit ratings. Many insurers use these scores in conjunction with other factors to underwrite and price personal automobile insurance policies, so as to most appropriately match an offered rate to the risk represented.

Insurance scores are not the same as credit scores. Credit scores predict credit delinquency while insurance scores are used to predict insurance losses. While both are based on an individual’s credit report, an insurance score is a tool that actuarially predicts the risk of an insurance loss. While many factors are used in the overall underwriting process, when calculating the insurance score, information such as income, ethnic group, age, gender, disability, religion, address, marital status and nationality are not considered.

Insurance underwriting and rating processes are designed to differentiate good risks from bad risks. To comply with state insurance regulations and offer competitive rates, an auto insurance company must be able to assess risks and price policies accurately according to the likely cost of claims generated by those policies. To be clear, insurers are prohibited from setting rates that unfairly discriminate against any individual by law in every state.

Many insurance companies use insurance scores for underwriting and rating because there are recognized actuarial, academic, and scientific studies that prove there is a strong relationship between insurance scores and insurance losses. And just as insurance scores help insurance companies assess and price risks, so too can these scores help insurance customers¹. Many

¹ <https://insurance.arkansas.gov/uploads/resource/documents/2017credit.pdf> In 2016 for some 3.4 million personal lines policies, 54.5 percent of those policies had a decrease in the final premium. In 19.8 percent of cases, it resulted in an increase. Credit scoring was a neutral factor—meaning it did not affect the outcome—in the remaining 25.7 percent of policies. Policies for which credit information decreased the premium outnumbered policies for which it increased the premium by 2.76 to 1.

customers see lower premiums when carriers use insurance scores.

Insurance scores are an actuarially proven tool for insurers to assess risk and the use of these scores serves policyholders

Numerous studies have found that credit-based insurance scores help insurers to better assess risk and develop rates that are more actuarially accurate. These studies concluded that credit may be correlated more strongly with risk than other, more traditional factors used in underwriting and rating. The National Association of Insurance Commissioners has compiled an extensive list of studies, reports and surveys² validating the use of credit and other factors in Insurance. Subsequent reports by the state regulators of insurance in Arkansas³, Nevada⁴, Texas⁵, Vermont⁶, and Virginia⁷ concluded that:

- Using credit score, insurers can better classify and rate risks based on differences in claim experience,
- Policyholders whose **premiums are based on credit-related insurance scores tend to pay lower annual premiums** than policyholders whose premiums do not include insurance scores,
- Most policyholders benefit from the use of credit scoring, and
- For those policies in which credit played some role in determining the final premium, those receiving a decrease outnumbered those who received an increase by 2.45 to 1.

Similarly, a Federal Trade Commission report to Congress, “Credit-Based Insurance Scores: Impacts on Consumers of Automobile Insurance”⁸ A Report to Congress by the Federal Trade Commission” in July 2007 concluded that credit-based insurance scores are effective predictors of risk for automobile insurance policies. The FTC found that using scores is likely to make the price of insurance conform more closely to the risk of loss that consumers pose, resulting, on average, in higher-risk consumers paying higher premiums and lower-risk consumers paying lower premiums.

A 2016 study⁹ by Georgetown University Law Center concluded that “insurance scores are predictive of risk because they operate as a rough measure of policyholders’ “level of caution” and that “the widespread use of insurance scores in auto coverage stems from a simple fact: they

²https://www.naic.org/documents/committees_c_d_auto_insurance_study_wg_related_studies_examining_use_credit_scoring.pdf

³ <https://insurance.arkansas.gov/uploads/resource/documents/2017credit.pdf>

⁴ Report on the Use of Consumer Credit and Loss Underwriting Systems,” Nevada Dept. of Business & Industry, Division of Insurance (2005)

⁵ <https://tdi.texas.gov/reports/documents/credit05sup.pdf>

⁶ Vermont Department of Financial Regulation: Study of Credit-Based Insurance Scoring (2016).

⁷ <https://rga.lis.virginia.gov/Published/2016/RD331>

⁸ <https://rga.lis.virginia.gov/Published/2016/RD331>

⁹ <https://scholarship.law.georgetown.edu/cgi/viewcontent.cgi?article=2530&context=facpub>

are predictive of claim risk.” A study¹⁰ out of the University of Texas Bureau of Business Research at the McCombs School of Business found: “The correlation between credit score and relative loss ratio is .95, which is extremely high and statistically significant. The lower a named insured’s credit score, the higher the probability that the insured will incur losses on an automobile insurance policy...” An EPIC Actuaries, LLC study¹¹ found: “Insurance scores are among the three most important risk factors for each of the six automobile coverages studied.”

Insurance scoring does not have a disparate impact or discriminate based on protected classes

Auto insurance, by its very nature, discerns between low risk and high risk. Individuals that an insurer concludes to present lower risks of loss pay less per unit of insurance than individuals who present higher risks of loss. Insurance companies invest huge amounts of money and resources into analyzing loss data and developing pricing strategies. Insurance actuaries rely on accepted principles and standards of practice to make these determinations. State insurance regulators then review these rates to prevent rates that are inadequate, excessive, or unfairly discriminatory, and to ensure that the risk classifications are based upon supportable actuarial evidence. Ratemaking then is a process of risk discrimination, but in the words of one federal¹² court, “risk discrimination is not racial discrimination.”²

Perhaps the most authoritative review of this issue has been performed by the Missouri Department of Insurance, “Financial Institutions & Professional Registration report on Private Passenger Automobile Insurance: A Review of The Market In Missouri”¹³, which looked at questions of affordability and availability of automobile insurance and analyzed 30 years of monitored insurance prices. The department’s 2018 report concluded that no evidence has been found that high minority areas are systematically overcharged relative to risk compared to low minority areas. Further, no evidence indicated that high minority areas are charged more relative to risk, nor is there an association between loss ratios and area income.

The specific question of whether insurance scoring produces rates that are unfairly discriminatory was also considered by the Michigan Supreme Court in 2010. The Court¹⁴ struck down a prohibition on use of credit scores, noting that a rate is not unfairly discriminatory if there is a “reasonable justification” for the differential in rates “supported by a reasonable classification system” and that there was a direct, linear relationship between insurance scores

¹⁰ A Statistical Analysis of the Relationship Between Credit History and Insurance Losses, Bureau of Business Research, The University of Texas at Austin, March 2003

¹¹ https://www.ask-epic.com/Publications/Relationship%20of%20Credit%20Scores_062003.pdf

¹² <https://www.justice.gov/sites/default/files/crt/legacy/2010/12/14/saunders.pdf>

¹³ <https://insurance.mo.gov/reports/documents/PrivatePassengerAutomobileInsuranceInMOrev7-11-2017.pdf>

¹⁴ https://media.lockelord.com/files/upload/Ins_Institute_of_Mich_v_Comm_Fin_Ins_Svcs.pdf

and risk for automobile policies. The Court concluded that the prohibition of insurance scoring would make insurance both less available and less affordable to Michigan residents.

The Michigan Court also rejected contentions that credit reports are inherently unreliable and their use therefore results in misclassification of policyholders. There are numerous state and federal provisions that provide consumer protection against credit reporting problems. The Fair Credit Reporting Act gives consumers new fraud and identity-theft protections. It allows them to opt out of information and entitles one free credit report a year upon request from the three major credit reporting agencies, Equifax, Experian and TransUnion. Consumers can obtain, examine and propose corrections in their free reports from a service¹⁵ funded by the three agencies.

While the 2016 study by Georgetown University Law Center further concluded that insurance scoring does not necessarily have a disparate impact on low income policyholders, there have been recent media reports using flawed methodologies to purport that insurers were charging statistically significantly higher premiums in predominantly minority zip codes. The discussion is significantly compromised by conflating “compositional effects” (risk differences associated with individuals residing in an area) with “area effects” (the risk arising from characteristics of the area itself, such as traffic density). More seriously the selection of a subset of ZIP codes for analysis introduced a strong statistical bias into the analysis. Namely, the subset of low-minority ZIP codes was composed of predominantly rural, sparsely populated areas with little to no statistical credibility and anomalously high losses.

Regulation of Insurance Scoring is a State Authority

States have stringent anti-discrimination provisions in general and specifically with respect to insurance. There is no data to indicate that these provisions or their enforcement have been inadequate or lacking in any aspect. Existing federal anti-discrimination provisions may apply as well.

Several states have adopted laws on credit or regulations based largely on the National Conference of Insurance Legislators’ model law, and other states have enacted laws that closely follow NCOIL’s provision that prohibits an insurer from denying, canceling, or nonrenewing a policy of personal insurance solely based on credit information without consideration of any other applicable underwriting factor independent of credit information.

Finally, any federal law or regulation that would prohibit or limit the use of insurance scoring is contrary to and prohibited by the McCarran-Ferguson Act, which was passed by Congress in 1945 to ensure the preeminence of state regulation of insurance. Under the act, “No Act of Congress shall be construed to invalidate, impair or supersede any law enacted by any State for

¹⁵ <https://www.annualcreditreport.com/index.action>

the purpose of regulating the business of insurance, or which imposes a fee or a tax upon such business." The McCarran-Ferguson Act gives primary authority over insurance regulation to the states. It is imperative that stability in insurance marketplaces is achieved for the benefit of all consumers. Altering longstanding usage of actuarial sound principles for companies to legally price the risk they undertake can have dramatic and unintended consequences.

Conclusion

Objective analysis and research have shown that insurance scores are a proven actuarial tool for insurers to assess risk, and that the use of these scores more often than not serves to benefit policyholders. Similarly, objective analysis has disproven claims that insurance scores have had discriminatory or disparate impact on protected classes. Further, state-based insurance regulation provides an ample and time-tested framework for oversight in this area, which is properly preserved for the states and therefore.



Discrimination Against Latinos in Auto Lending

Submitted to

**House Financial Services Committee
Subcommittee on Oversight and Investigations**

Submitted by

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Introduction

UnidosUS, formerly the National Council of La Raza, is the largest national Hispanic* civil rights and advocacy organization in the United States. For more than 50 years, we have worked to advance opportunities for low-and moderate-income Latino families so that they can achieve economic stability and build wealth. In this capacity, UnidosUS, with its network of nearly 300 Affiliates—local, community-based organizations in 35 states, the District of Columbia, and Puerto Rico—provides education, health care, housing counseling, workforce development, and financial coaching programs to millions of citizens and immigrants in the United States annually.

For almost three decades, UnidosUS has conducted research and analysis and has testified before Congress on issues related to improving the financial well-being of Latinos; including strengthening the Community Reinvestment Act and the Home Ownership and Equity Protection Act (HOEPA), supporting strong fair housing and lending laws, and expanding access to affordable credit. In addition, UnidosUS manages a network of more than 30 community-based, financial coaching agencies in more than 20 states across the country. Since its inception, the UnidosUS financial coaching network has helped more than 50,000 families better understand the financial landscape and improve their credit standing to pursue their financial goals. Additionally, UnidosUS was a supporter of the Dodd–Frank Wall Street Reform and Consumer Protection Act and the creation of the Consumer Financial Protection Bureau (CFPB). The establishment of CFPB marked a new era for Latino consumers, with a “cop on the beat” to ensure that every day people interacting with the financial system would be treated fairly.

This written statement focuses on how Latinos are affected by the auto loan industry and its pattern and practice of discriminatory lending—especially regarding indirect auto lending and dealer markup practices. It also addresses how discrimination in auto lending impacts the financial standing of Latinos.

Background

Automobiles are an important mode of transportation in the United States. In many areas public transportation alternatives either do not exist or are not a viable substitute for a car.¹ Americans’ reliance on cars is demonstrated by the fact that 86% of all households and 76% of minority households own a car.² Additionally, transportation is the second-largest expense for American households after housing.³ The average American household spends more than \$4,000 a year on vehicle purchases, nearly \$2,000 on fuel and motor oil, and nearly \$1,000 each on vehicle insurance and repairs.⁴ The high cost of car ownership forces many Americans to borrow money in order to have reliable access to a car, and the share of Americans with vehicle debt has grown over time. For example, in the third quarter of 2018, 85% of all new car purchases relied on financing, compared with 75% in 2009.⁵ The amount owed by the average American on their car

* The terms “Hispanic” and “Latino” are used interchangeably by the U.S. Census Bureau and throughout this document to refer to persons of Mexican, Puerto Rican, Cuban, Central and South American, Dominican, Spanish, and other Hispanic descent; they may be of any race.

loans increased from \$2,960 in 2003 to \$4,520 in 2017—an increase of 53% in nominal terms and 33% when adjusted for inflation.⁶

Automobiles are especially important for Latinos. Cars are the second-largest financial transaction that a Latino family makes, and most take out a loan to finance their purchase.⁷ Often Latino families receive this loan from an auto dealership rather than directly from a financial institution—a practice known as “indirect auto lending.”⁸ In indirect auto lending, the dealer uses a third party lender—such as a bank, credit union, or other financial institution—to establish an interest rate for the loan.⁹ When the dealer relays this interest rate to the customer, it is generally higher than the rate the lender quoted to the dealer. This increase in rate is typically called a “dealer markup.”¹⁰ The lender shares part of the revenue from the increased interest rate with the dealer. Interest rate markups generate compensation for dealers while providing them with discretion to charge consumers a different rate than the lender, regardless of consumer creditworthiness, costing customers \$1.1 billion annually.¹¹ It is estimated that between one-third and more than one-half of car buyers use dealer financing.¹²

The ability for auto lenders to increase a customer’s interest rates has led to differences in pricing based on race, national origin, and other illegal bases.¹³ In 1991, Yale Law Professor Ian Ayers conducted a study by sending testers of various races and ethnicities to new car dealerships in Chicago and found that Black male testers were asked to pay more than twice of what was asked of White male testers.¹⁴ More recently, both the CFPB and the Department of Justice (DOJ) concluded in recent investigations that car dealerships’ practice of marking up interest rates for auto loans results in discrimination for minority buyers.¹⁵

Latinos are frequently targets of these discriminatory practices and are often charged higher markups than other similarly situated consumers. For example, according to a 2018 study by the National Fair Housing Alliance (NFHA), 62.5% of the time non-White testers who were more qualified in terms of credit scores and income-to-debt ratios than their White counterparts, received higher pricing options and less favorable lending terms.¹⁶ Because of these discrepancies, NFHA found that non-White testers who experienced discrimination would have paid an average of \$2,662.56 more over the life of their auto loan than less-qualified White borrowers. Additionally 75% of the time, White testers were offered more financing options than non-White testers. And, dealers offered to help reduce interest rates and car prices using incentives and rebates for White testers more often than they did for non-White testers.¹⁷

Continued Loosening of Lending Standards Has Created a Subprime Auto Lending Market

During the Great Recession, American homeowners including Latinos, were disproportionately steered into unaffordable, subprime loans. As a result of this practice, homeowners who lost their homes to foreclosure suffered a tremendous loss of home equity and damaged credit. In the auto lending market, lenders have also moved towards subprime loans. Specifically, these loans extend the length of repayment terms, lend at higher loan-to-value ratios, and fail to take

into consideration a borrower's ability to repay. In 2009, only 14% of auto debt was subprime or below.¹⁸ But by 2016, lending to subprime and deep subprime borrowers made up as much as 26% of all auto loans originated that year.¹⁹

While longer-term loans result in smaller, more manageable monthly payments that increase the affordability of a vehicle purchase, the speed with which vehicles depreciate often result in consumers becoming "underwater" on their loans. Research suggests that longer loan terms are particularly important in encouraging low-income borrowers to purchase cars, while higher income purchasers are more sensitive to interest rate changes.²⁰ The CFPB found that in 2017, the average credit score of a borrower taking out a six-year auto loan was 39 points below that of a borrower with a five-year term auto loan. Because subprime borrowers typically pay higher interest rates on auto loans, the effect of a longer term on the total cost of the vehicle over time is magnified.²¹ A borrower with a six-year loan is twice as likely to default as one with a five-year loan.²²

Abusive and Predatory Loan Practices Threaten Latino Economic Security

Certain lending practices in the subprime auto market are saddling consumers with excessive debt, threatening their long-term economic security. The practices described below are among the more common encountered in the subprime market.²³

Excessive Interest Rates

Consumers with low credit scores or no credit history are typically subject to higher interest rates in their limited credit options. Some dealers who finance the vehicles themselves ("buy here, pay here" businesses) are able to charge even more excessive rates by locating in states that are exempt from state usury laws.²⁴ These high interest loans make the car purchase more expensive and make it more likely for a borrower to default.

Misleading and Incomplete Information

Borrowers may not be given accurate information about the total loan cost from a subprime auto lender or dealer, or misled about the presence of add-on products or the full terms of the loan. Additionally, the increasing use of electronic contracts (e-contracts) can make it easier to hide fees and loan terms and make it difficult to review important information in fine print. Another tactic some dealers have used is to first push consumers into a conditional sales agreement rather than a final sale. Once the buyer has taken the car home, the dealer will claim it is difficult to finance the loan and require the borrower to return the car and renegotiate a new loan that will most likely be to the borrower's disadvantage.²⁵

Ability to Repay Not Taken into Consideration

Another troubling pattern similar to the subprime mortgage crisis is that some subprime auto lenders and dealers will inflate a borrower's income and require no income verification. This will qualify them for a higher loan than they would receive, if the loan had adhered to traditional underwriting standards. This ultimately harms consumers, who may end up with car payments they cannot afford or are unable sustain for the duration of the loan.

Bogus and Unnecessary Fees and Products

Dealers can steer customers toward overpriced add-on products and lead the customer to believe the products are mandatory, when they are not. In addition, inflated fees for items like paperwork filing can add to the initial cost of a vehicle.²⁶ These additional costs can be difficult for a customer to decipher or reject when they are presented in a deceptive manner by the dealer. For example, in 2018, Wells Fargo was ordered to pay a \$1 billion fine for charging more than half a million car loan customers for additional insurance they did not need. Wells Fargo is also required to provide hundreds of millions of dollars in relief to affected customers.²⁷

Abusive Collection and Repossession Tactics

If a customer is ultimately unable to afford their car loan, it will likely be repossessed. While this is a practice that is not necessarily predatory, some auto lenders have monetized repossessions at the expense of borrowers, making it a new business model. In many repossession cases, borrowers who are underwater on their loans end up with an outstanding balance, even after the vehicle is repossessed. This enables the lender to collect repossession fees, try to collect past-due payments, and in some cases, sue delinquent borrowers for the remaining balance.²⁸ Some dealers will try to pressure a customer whose vehicle was repossessed to regain their car, even in instances where it was clear the customer could not afford the payments. This has resulted in the same vehicles being repossessed several times, driving customers further into cyclical debt.²⁹

Conclusion

Given these predatory practices that have a discriminatory impact on Latinos, the CFPB's oversight authority should be expanded to auto dealers to better address marketplace discrimination directly and through coordinated efforts with state Attorney's General and the Federal Trade Commission (FTC). By expanding the CFPB's jurisdiction, Latinos and other vulnerable customers will be protected from predatory practices that can weaken their financial standing.

¹ UnidosUS, "Latino View on the Car-Buying Experience," (Washington, DC: UnidosUS, 2017) 11-17.

² Letter from Eric Rodriguez, Vice President, UnidosUS, to Paul Ryan, Speaker of the House of Representatives and Nancy Pelosi, United States Representative, April 25th, 2017.

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- ⁸ Consumer Financial Protection Bureau, Consumer Financial Protection Bureau to Hold Auto Lenders Accountable for Illegal Discriminatory Markup (Washington, DC: CFPB, 2015).
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American Financial Services Association

**Fair Lending:
Implications for the Indirect Auto Finance Market**

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Table of Contents

1. BACKGROUND.....	8
2. APPROACH AND METHODOLOGY.....	8
2.1. DATA.....	9
3. THE RETAIL AUTOMOTIVE FINANCE MARKET	9
3.1. MARKET SIZE	10
3.2. MARKET SEGMENTS	11
3.2.1. Direct and Indirect Channels.....	11
3.2.2. New and Used Vehicles.....	12
3.2.3. Prime, Non-Prime or Subprime Consumers	13
3.2.4. Lease or Purchase	14
3.3. MARKET PARTICIPANTS	15
3.3.1. Consumers	15
3.3.2. Types of Financial Institutions.....	17
3.4. MARKET CONCENTRATION.....	17
3.5. SEGMENT SPECIALIZATION	20
3.6. SOURCES OF CAPITAL.....	20
3.7. COMPETITIVE FACTORS	22
3.7.1. Online Credit Application Networks – the efficient auction	24
3.7.2. Dealers	25
3.7.3. Vehicle Manufacturers	31
3.7.4. Bringing it all together – transactions.....	32
4. FAIR LENDING COMPLIANCE FOR INDIRECT AUTOMOTIVE FINANCE	34

4.1.	BACKGROUND	34
4.2.	ECOA – DISPARATE IMPACT AND TREATMENT.....	38
4.3.	FAIR LENDING AND DEALER RESERVE	41
4.4.	IDENTIFYING RACE AND ETHNICITY FOR VEHICLE PURCHASES.....	45
4.4.1.	Vehicle purchases by Race/Ethnicity Shares	48
4.4.2.	Specific Proxy Methods	51
4.4.3.	Testing of Specific Proxy Methods.....	54
4.5.	MEASUREMENT OF DEALER RESERVE	63
4.6.	COMPLEXITY OF THE TRANSACTION.....	64
4.6.1.	Unknown consumer-specific factors	65
4.6.2.	Unknown dealer-specific factors.....	67
4.7.	PRICING DIFFERENCES ACROSS DEALERS	70
4.8.	OBSERVABILITY OF DEALER CONTRACTS	71
5.	OBSERVED PRICES IN THE CURRENT MARKET.....	72
5.1.	OBSERVED CONTRACT RATES AND BUY RATES.....	73
5.2.	SIMILARLY SITUATED CONSUMERS AND CONTROLS	76
5.2.1.	Adjusting for proxy bias.....	77
5.2.2.	Deal Specific Controls.....	79
5.2.3.	Unknown Factors.....	80
6.	ALTERNATIVE DEALER COMPENSATION MODELS	81
6.1.	CFPB AND DOJ PREFERENCES	82
6.2.	TESTING.....	82
6.2.1.	Scenario 1.....	83
6.2.2.	Scenario 2.....	83

6.2.3. Scenario 3.....	84
6.2.4. Scenario 4.....	84
7. CONCLUSIONS AND RECOMMENDATIONS.....	85
8. APPENDIX A. PROJECT TEAM.....	88
9. APPENDIX B. GLOSSARY OF TERMS AND ACRONYMS.....	90
10. APPENDIX C. HOUSEHOLD VEHICLE OWNERSHIP BY STATE AND RACE/ETHNICITY, 2010-2012.....	94
11. APPENDIX D. BISG ASSUMPTIONS USED BY CHARLES RIVER ASSOCIATES FOR THIS STUDY	100
12. APPENDIX E. RACE/ETHNICITY PROXIES: DIFFERENCES BETWEEN BISG CALCULATIONS: CRA V. CFPB	101
13. APPENDIX F. BISG 2-WAY TABLES, "HEAT-MAPS"	105
14. APPENDIX G. BISG FALSE POSITIVES AND NEGATIVES BY TRACT, FICO, INCOME, AND LMI.....	107
15. APPENDIX H. CRA CONTRACT DATA VARIABLES	111
16. APPENDIX I. CRA CONTRACT DATA DESCRIPTIVE STATISTICS	112
17. APPENDIX J. DEALER RESERVE REGRESSION RESULTS	128
18. APPENDIX K. COST/BENEFIT SCENARIO RESULTS.....	132
19. APPENDIX L. CHARTS AND TABLES	140
20. APPENDIX M. REFERENCES.....	141

INTRODUCTION

Over the past few years, regulatory focus on fair lending examination of the indirect automotive finance market has increased significantly. Recent regulatory developments that impact the indirect auto finance market include the issuance on March 21, 2013 of the Consumer Financial Protection Bureau (CFPB) Bulletin 2013-02,¹ "Indirect Auto Lending and Compliance with the Equal Credit Opportunity Act" (Bulletin) which details the manner in which certain policies related to dealer discretion have the potential to create significant fair lending risks for financial institutions that participate in this important consumer market.² At the same time, methodologies used by regulatory agencies for fair lending examinations have changed significantly. For example, the CFPB issued "Using Publicly Available Information to Proxy for Unidentified Race and Ethnicity" (White Paper) on September 17, 2014 which presents its methodology for using a proxy to assign race/ethnicity to consumers obtaining auto financing.

In this research, we illustrate the complexities of indirect automobile financing and evaluate current regulatory fair lending practices observed in the industry. The research uses data collected from a number of market participants and aggregated in order to inform the discussions concerning dealer compensation, prices observed in the market, and the costs and benefits to consumers of alternative dealer compensation methods.

Highlights of the study include demonstrating that:

- The markets for purchasing automobiles (the retail automotive market) and for financing automobiles (the automotive finance market) are complex, highly interconnected and highly competitive.
- Accurately analyzing dealer reserve is difficult for a number of reasons, and failure to consider these challenges increases the potential for drawing erroneous conclusions.
- The methods commonly used by regulators to proxy race and ethnicity, including the recently applied Bayesian Improved Surname Geocoding

¹ CFPB Bulletin 2013-02, March 21, 2013.

² In this paper we use the term 'financial institution' to refer to any company that finances new or used vehicle sales. Financial institutions include banks, non-banks, credit unions, captive and non-captive companies, direct lenders and indirect finance companies, and buy-here pay-here dealers.

(BISG) method, are conceptually flawed in their *application* and subject to significant bias and estimation error.

- The use of biased race and ethnicity proxies creates significant measurement errors, which likely result in overstated disparities and overstatements of alleged consumer harm.
- 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.
- 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 appropriately considering the relevant market complexities and adjusting for proxy bias and error, the observed variations in dealer reserve are largely explained.
- Alternative dealer compensation structures, such as “flats,” may lead to increased borrowing costs for many minority and non-minority consumers and, in turn, may limit access to credit for some consumers.

A first step in designing an appropriate fair lending strategy is developing the conceptual framework. The intricacies of this very complex market require more complex strategies than those used to date. Given the realities of the regulatory landscape and the limited tools available for analysis, the ability to perform meaningful, accurate and actionable analyses of dealer reserves at the portfolio level is very circumscribed. Based on our analysis, we offer the following key recommendations:

- In calculating any disparities at the portfolio level, make adjustments to the population to:
 - Exclude any volumes from dealers with zero dealer reserve.
 - Exclude any volumes from dealers with no variance in reserve.
 - Exclude any dealers with counts insufficient to monitor dealer activity – specifically, exclude dealers with fewer than 2 contracts from a protected class member and 2 contracts from non-Hispanic whites and a total of 5 contracts. (Similar restrictions should be applied when analyzing for age or gender).
- Implement economic controls to adjust for general economic conditions beyond the control of the financial institution or dealer. Specifically, adjust for:

- Location – the analyses should include MSA level fixed effect controls. Market demand/supply conditions vary by MSA.
 - New/Used – these markets are completely different on many dimensions and the negotiation around trade in values may directly impact dealer reserves.
 - Broad credit tranche – this is not equivalent to controlling for credit score in the buy rate analysis but rather recognizes that prime and subprime markets vary broadly.
 - Month of origination.
- Adjust for the known bias in the use of the BISG proxy methodology:
 - If using a continuous approach, determine the “count” of affected minority consumers by applying a threshold after the application of the continuous method. At the very least, the consumers with BISG probabilities less than 50% should not be included in any calculation of consumer harm.
 - Require verification/certification that any consumer receiving settlement funds or other remediated responses actually is a member of a protected class.
 - If funds remain in the settlement fund, these should revert to the financial institution and not become part of any regulatory “settlement fund.”
- When applying the BISG method, use a stricter threshold for any actions taken prior to 2012. The BISG approach had never been used historically, no one would have used it for monitoring, and applying a recent innovation to past behavior is unfair to financial institutions. For all originations prior to 2011, a 70% BISG threshold, or similar, should be applied.
- Going forward, while financial institutions may, given sufficient volumes, monitor activity quarterly, no remediation should take place until the end of the year. This will help adjust for seasonality during an annual cycle.
- The analysis should include a dealer level focus. There must be adjustments for the aggregation issue.
- The continuous BISG methodology should not be used in any analysis of indirect auto underwriting. The econometric interpretation of such a result is overly difficult.

1. BACKGROUND

Historically, most research on fair lending has followed the focus of regulatory enforcement on discrimination in mortgage markets, and far less research or supervisory activity involved the automotive retail market. To assist in filling the research void that exists, this study provides examination of the following:

- the size and scope of the vehicle finance market.
- the history and evolution of indirect auto finance.
- the Equal Credit Opportunity Act (ECOA) and disparate treatment and impact.
- the history, applicability and accuracy of proxy analysis, including BISG.
- quantitative analysis of current pricing practices in the vehicle finance market.
- the identification and quantitative analysis of factors potentially impacting dealer participation.
- the identification and quantitative analysis of alternative dealer compensation methods, including an assessment of whether such alternative dealer compensation methods are likely to adversely impact the availability of credit for protected classes and lower income groups.

2. APPROACH AND METHODOLOGY

The research focuses on answering the following key questions:

1. What is the automotive finance market and how does it function?
2. Are there fair lending concerns with dealer discretion and dealer reserve?
 - a. Can these concerns be reliably addressed?
 - i. What are the challenges and how may they be addressed?
 - ii. What information is needed for financial institutions and dealers to monitor fair lending risk?
 - iii. What dealer reserve prices are observed in the market and what explains variations in those prices?
 - b. What are the advantages and disadvantages of particular methodologies?
3. What are alternative dealer compensation structures and how would they impact consumers' cost and access to credit, as well as other market participants including dealers and financial institutions?

We have analyzed these questions through an examination of the historical record, economic and financial theory, prior research, and empirical analysis. Our findings and analysis are presented in the following sections.

2.1. DATA

The study utilizes information obtained from numerous publicly available automotive industry sources such as WardsAuto, Automotive News, Manheim, J.D. Powers, the National Automobile Dealers Association (NADA), the National Independent Automobile Dealers Association (NIADA) and others. Additionally, Experian Automotive made available to us a wide variety of data including information on dealers and financial institutions operating in the automotive finance market.

Beyond these industry data, this research used contract-level data for vehicle purchase transactions combined in a large database (CRA Contract Data) consisting of approximately 8.2 million new and used vehicle contracts originated during 2012 and 2013. The contracts were purchased from dealers by numerous financial institutions including banks, captive finance companies, other non-bank entities. Some of the financial institutions purchased contracts from dealers located across the country, while other focused on dealers in a particular geographic region. Some of the financial institutions purchased contracts across a broad spectrum of credit risk, while others specialized in particular credit tranches. The contributors include many of the 10 largest financial institutions in the indirect automotive finance market. For each contract the database included deal-specific attributes, including the contract rate, buy rate, amount financed, and term.³ The database was anonymized with respect to the dealer that originated the contract, the financial institution to which it was assigned and the buyer and co-buyer (if applicable) associated with the contract.

We obtained geocoding and mapping services from Pelican Mapping in order to assign each contract to a census tract.⁴

3. THE RETAIL AUTOMOTIVE FINANCE MARKET

The retail automotive finance market is highly competitive and cyclical. Understanding the options available for the financing of vehicles, requires understanding the structure, size and segments of this market, the key participants

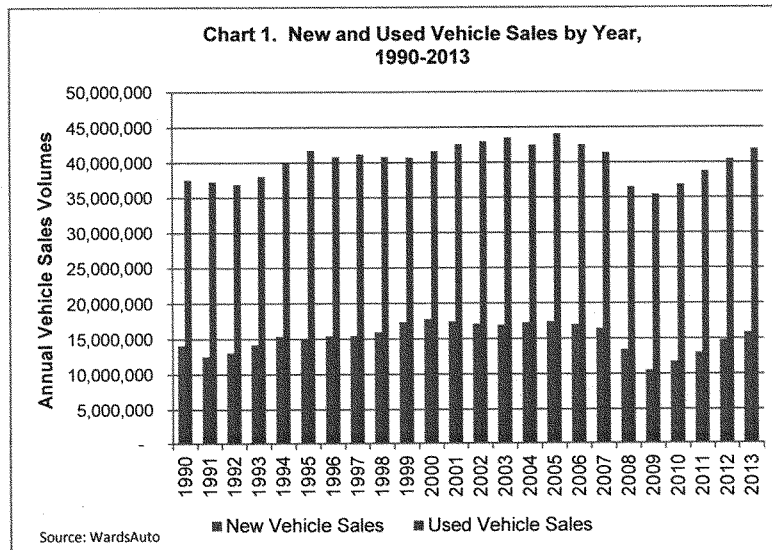
³ See Appendix H for a complete list of the fields included in the CRA Contract Data.

⁴ Glenn Waldron, Pelican Mapping, assisted with this project. For further information, see <http://pelicanmapping.com/>.

and their respective roles. Any discussion of the prices charged by dealers, financial institutions or other market participants must be grounded in the economics of the relevant market(s). While this is not a particularly robust area of academic literature, some researchers have studied various aspects of the complex pricing mechanisms in the retail automotive market. A few have examined prices and race. We reference this literature throughout the study.

3.1. MARKET SIZE

The market for vehicle sales is large. WardsAuto reports sales of new and used vehicles in the U.S. during 2013 of 15.9 million and 42.0 million vehicles, respectively.⁵ Annual new and used vehicle sales volumes are reported in Chart 1 for the period 1990-2013.



⁵ New vehicle sales include cars, light trucks and medium/heavy trucks. Used vehicle sales include those by franchised dealers, independent dealers and casual/private sales. See 2014 NIADA Used Car Industry Report, at 17.

While sales volumes have rebounded since the Great Recession of 2008-2010, sales in 2013 were still below pre-recession levels. Cyclical activity correlated with overall levels of economic activity reflects the norm in this market. Decreases in new sales volumes in 1991, 2001-2003 and 2007-2009 can be observed in Chart 1. The 2013 new and used sales volumes suggest an automotive finance market of approximately \$610 billion.⁶ As of June 30, 2014, auto finance debt represents about 8% of aggregate consumer debt, well behind mortgage debt (70%) and less than student loan debt (10%).⁷

3.2. MARKET SEGMENTS

The automotive finance market provides access to credit through lease and purchase options for a wide range of market segments which include direct and indirect finance channels, new and used vehicles, and prime, non-prime, and subprime buyers.

3.2.1. DIRECT AND INDIRECT CHANNELS

Financial institutions in the direct channel originate loans directly to consumers for the purpose of purchasing a new or used vehicle. Once a consumer is approved by the financial institution, the consumer consummates the vehicle purchase, generally at a dealer, subject to the terms approved by the financial institution. In the direct channel, financing and purchasing the vehicle are related but separate transactions.

Financial institutions in the indirect channel purchase retail installment sale contracts (contracts) from a dealer. The pricing practices within the indirect channel are a key focus of current regulatory fair lending scrutiny. In the indirect channel, there is no direct contact between the financial institution and the buyer at the time of vehicle purchase. The contracts are negotiated by the dealer directly with the consumer. To facilitate these transactions, financial institutions determine which contracts they are willing to purchase and offer dealers wholesale financing rates, often called 'buy rates.' The dealer and consumer negotiate financing in the same transaction as the vehicle purchase. The dealer assigns the contract to a financial institution willing to

⁶ Market for new vehicles = $15.88M \times 31,000 \times .793 = \$390B$, plus market for used vehicles = $42M \times \$10,000 \times .52 = \$220B$ = total vehicle finance market \$610B.

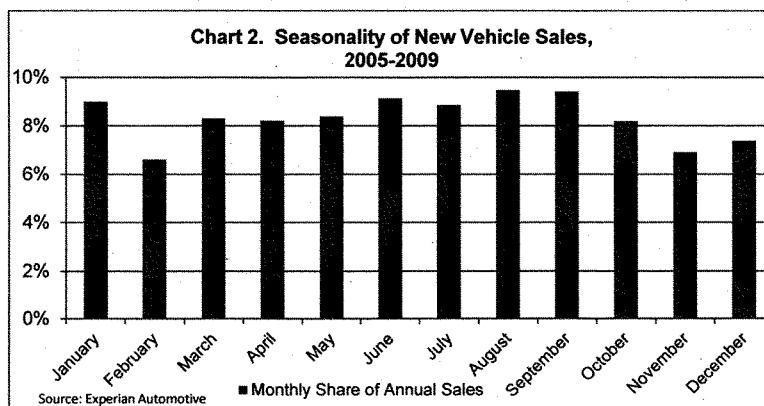
⁷ "Quarterly Report on Household Debt and Credit," Federal Reserve Bank of New York, August 2014, available at: http://www.newyorkfed.org/householdcredit/2014-q2/data/pdf/HHDC_2014Q2.pdf, last accessed September 8, 2014.

purchase it. In effect, the dealer is auctioning the contract and financial institutions are competing to purchase it and compensate the dealer.

While this research focuses on the indirect channel, the actions and reactions in one channel clearly impact the other channel (direct) and all participants in the market.

3.2.2. NEW AND USED VEHICLES

While the basic difference between these two market segments is obvious, a number of important differences may be less apparent. New vehicle transaction prices have a wide range and are significantly higher than used vehicle transaction prices for similar vehicle makes and models. According to NADA, the average retail selling price of a new vehicle in 2013 was \$31,762.⁸ Consequently, the vast majority of vehicle buyers finance their purchases. In 2013, approximately 79% of new vehicle sales were financed by the buyer at the time of purchase.⁹ In addition to economic cyclicity, new vehicle sales trends reflect significant annual seasonality, which can be seen in Chart 2. Model year changes and product life cycles contribute to these trends.



⁸ NADA DATA, 2014, at 3, available at: http://www.nada.org/NR/rdonlyres/DF6547D8-C037-4D2E-BD77-A730EBC830EB/0/NADA_Data_2014_05282014.pdf, last accessed September 8, 2014.

⁹ This percentage is based on analysis of vehicle titles by Experian Automotive. Of the remaining 21%, some consumers may use home equity lines of credit or other sources of financing.

Additionally, new vehicles are sold exclusively by franchised dealers.¹⁰ We discuss the role of franchised dealers in greater detail below, but it is important to understand that franchised dealers, for a variety of reasons, are materially different than independent dealers.

Used vehicles, unlike new vehicles, may be sold by franchised dealers, independent dealers and in private transactions with no dealer involvement. These channels accounted for 37%, 34% and 29%, respectively, of used vehicle transactions in 2013.¹¹ Used vehicles can be further categorized as: 1) certified pre-owned (CPO) vehicles, generally 1-3 years old; 2) late-model vehicles, generally less than 6 years old, and 3) older-model used vehicles.¹² Transaction prices vary greatly within and across these different segments.¹³ NADA reports the average used vehicle price at franchised dealers was \$18,111 in 2013.¹⁴ This contrasts with the average used vehicle price at independent dealers and in private transactions of \$9,500 and \$7,000, respectively, in 2013.¹⁵ The pricing distributions suggest that the need for consumers to obtain financing for used vehicles transactions varies significantly across these segments. In 2013, approximately 52% of all used vehicles sales were financed by the consumer.¹⁶

3.2.3. PRIME, NON-PRIME OR SUBPRIME CONSUMERS

The credit market segments within the automotive finance market are defined almost exclusively by the creditworthiness of the consumer. While different financial institutions may have different thresholds for each group, nearly all use some form of automated credit score, obtained from internal models or external sources, to

¹⁰ The vast majority of franchised dealers are independent third parties. At any given point in time, there are a few manufacturer-owned dealers. These generally relate to highly specific facts and circumstance.

¹¹ WARDS Auto, U.S. Market Used Vehicle Sales, percentages for 2013.

¹² "2014 Used Car Market Report," Manheim, available at: http://www.niada.com/uploads/dynamic_areas/wp6QIPSw6C83LYM1dGrU/33/UCMR_2014_Final.pdf, last accessed September 8, 2014.

¹³ For an interesting discussion of used vehicle prices, depreciation rates and the effect of asymmetric information on market structures, see Avner Offer, "The markup for lemons: quality and uncertainty in American and British used-car markets c. 1953-73," *Oxford Economic Papers* 59 (2007), i31-i48.

¹⁴ *Op. Cit.*, NADA DATA 2014, at 3.

¹⁵ WardsAuto, U.S. Market Used Vehicle Sales.

¹⁶ *Op. Cit.*, Analysis of vehicle titles by Experian Automotive.

categorize potential vehicle buyers. Unlike mortgage markets, where certain loan products came to be known as 'subprime products,' in auto finance there is no analogous subprime automotive product.¹⁷ For example, in automotive finance there are no commonly used automotive finance products that reflect interest only loans, negatively amortizing loans, or no documentation loans.

Based on data provided by Experian Automotive, the 2013 market for financed new vehicles consisted of 64% prime buyers, 20% non-prime buyers and 16% subprime buyers.¹⁸ The distribution of buyers who finance used vehicle transactions in 2013 is significantly more weighted to the non-prime (22%) and subprime (43%) categories, with only 35% of financed used vehicle buyers in the prime category.

3.2.4. LEASE OR PURCHASE

Automotive finance products differentiate between lease and purchase contracts. Most auto finance leases are closed-end leases, providing long-term rental, with the consumer agreeing to lease the vehicle for a pre-determined period of time for a given monthly payment, with the return of the vehicle at the end of the period with no remaining liability, unless the consumer exercises a purchase option. Leases are most predominant in the new car market and are frequently subsidized by the vehicle manufacturer. As such, their availability may be tied to specific vehicle makes and models. During the Great Recession, many financial institutions eliminated or significantly reduced the availability of leases, but lease penetration rates have rebounded in recent years. In 2012, leases accounted for approximately 18% of new vehicle deliveries.¹⁹ While leases are not the subject of this study, they are one of the many choices available to consumers in the auto finance market and they may impact affordability in the new vehicle market.

Vehicle purchase agreements are structured as retail installment contracts in the indirect channel or as consumer loans in the direct channel. In both cases, the agreements specify the amount financed, the contract/loan term, and the annual percentage rate (APR). These components dictate a fixed monthly payment for the life of the contract or loan.

¹⁷ Product design in auto finance is constrained by the depreciating value of the underlying asset.

¹⁸ Prime, non-prime and subprime are defined in the Experian Automotive report to be 680+, 620-679 and <620, respectively.

¹⁹ Source: WardsAuto.

3.3. MARKET PARTICIPANTS

The automotive finance market has four primary participants: consumers, financial institutions, dealers and manufacturers, each with distinct objectives, incentives and constraints. These groups are not homogeneous and may be further segmented.

3.3.1. CONSUMERS

Industry reporting suggests that approximately 34 million consumers financed vehicle transactions in 2013 but limited information exists with respect to the demographics of this group.²⁰ WardsAuto reports selected demographics for new vehicle buyers. For example the median income of buyers of 2013 model year passenger cars is reported to exceed \$90,000, and approximately one-third of such vehicle buyers are 60+ years of age, while only about 4.5% are under age 25. Eighty-five percent of new light duty truck buyers were male in 2013, while 38% of new passenger car buyers were women.²¹ Survey data collected by the Census Bureau and Bureau of Labor Statistics reports vehicle ownership patterns vary considerably by race.

Data suggest that a diverse group of consumers finance vehicle purchases, and possess, on average, better credit and higher incomes than the overall population. Beyond the demographics, consumers have preferences and constraints that inform their vehicle purchase and finance decisions, as well as the prices they face and their willingness to pay them. Those include, but are not limited to, the following:

- The type of vehicle (class, make, model and options).
 - Strength of preference for desired vehicles.
- Flexibility with respect to timing of purchase.
- Alternative forms of transportation.
- Purchase vs. lease.
- Intended length of use.
- Experience from previous vehicle purchases.
- Need to sell existing vehicle:
 - Trade-in or sell independently.
- Availability of cash to use as down payment.
- Aggregate and/or monthly budget.

²⁰ New vehicles financed = $15.88M \times .793 = \$12.53M$, plus market for used vehicles financed = $42M \times .52 = \$21.84M = 34.37M$ financed vehicle transactions.

²¹ Source: WardsAuto

- Where to service the vehicle post purchase.
- Time, inclination and access to:
 - Multiple dealers.
 - Affinity for comparison shopping.
 - Online vehicle information sites (Edmunds.com, Truecar.com, Cars.com, Kelly Blue book, Autotrader, manufacturers' websites, etc.).
 - Financial resources:
 - Creditworthiness.
 - Financial literacy.
 - Existing non-auto relationships with banks or credit unions.
 - Other direct automotive financial institutions.

While consumers vary in their preferences and resources, a key difference among them is their access to and usage of the Internet. A group of researchers has studied the degree to which the Internet has lowered consumer prices in the retail automobile market and found that prices fell by 22% of a dealer's average gross vehicle profit.²² Their findings are "consistent with the Internet facilitating information search and removing important cues that salespeople can use to assess a consumer's willingness to pay."²³ Further, their research suggests use of the Internet may neutralize pricing differences previously explained by differences in education and income, among other attributes.²⁴ Economic theory and research suggests that the consumer who arrives at the dealer with an understanding of the finance rates available through the direct channel is better positioned to extract lower finance rates in the indirect channel at the dealer and may obtain rates lower than available in the direct channel.²⁵

²² Florian Zettelmeyer, Fiona Scott Morton, Jorge Silva-Risso, "How the Internet Lowers Prices: Evidence from Matched Survey and Automobile Transaction Data," *Journal of Marketing Research*, Vol XLIII (May 2006), 168-181.

²³ Fiona Scott Morton, Florian Zettelmeyer, Jorge Silva-Risso, "Consumer Information and Discrimination: Does the Internet Affect the Pricing of New Cars to Women and Minorities?," *Quantitative Marketing and Economics*, 1, 65-92, 2003.

²⁴ *Ibid.*

²⁵ For an interesting study of asymmetric information in retail automotive sales please see: Meghan Busse, Florian Zettelmeyer, Jorge Silva-Risso, "\$1000 Cash Back: Asymmetric Information in Auto Manufacturer Promotions," NBER working paper series, Working Paper 10887 <http://www.nber.org/papers/w10887>.

3.3.2. TYPES OF FINANCIAL INSTITUTIONS

Collectively, thousands of banks, credit unions, captive and independent finance companies compete in the market to finance vehicles. While banks and credit unions lend in many consumer markets, non-bank captive and independent finance companies are quite specific to the automotive finance market.²⁶ Some non-banks may offer other products and services to the dealer or its customers.

Captive finance companies are highly unique versions of a non-bank finance company. Traditionally, captive finance companies were the wholly-owned subsidiaries of the vehicle manufacturers. The "Big 3" Detroit manufacturers,²⁷ as well as the three major Japanese manufacturers,²⁸ have historically had captive finance subsidiaries that played an important role in retailing and financing new vehicles. For example, Ford Motor Credit is the captive finance company of Ford Motor Company, which manufactures Ford and Lincoln vehicles. In addition to financing consumers' vehicle purchases, captive finance companies offer numerous products and services to the dealers franchised by the captive finance company's manufacturer parent. These products address the commercial lending needs of the dealer, such as floor-plan financing, working capital loans, and construction loans; as well as finance and insurance (F&I) products, such as extended warranties and Guaranteed Auto Protection (GAP) insurance, that the dealer sells to vehicle purchasers.²⁹ Additionally, captive finance companies enter into agreements with the manufacturer-parent to offer subsidized customer incentives to the auto finance market.³⁰ A common example of such customer incentives are manufacturer-subservent finance rates (e.g. the 0.0% APR).

3.4. MARKET CONCENTRATION

The automotive finance market in the U.S. is very diverse. In 2013, nearly 65,000 financial institutions financed vehicle purchases. The top 10 financial institutions accounted for only around 37.7% of all vehicle finance transactions, and no single

²⁶ The larger non-bank auto finance companies include CarMax Auto Finance, Credit Acceptance and World Omni. Source: Experian Automotive.

²⁷ Chrysler Motors, Ford Motor, and General Motors.

²⁸ American Honda Motor, Nissan North America and Toyota Motor.

²⁹ Captive finance companies compete with banks, insurance companies and other finance companies to provide these products and services to the dealer.

³⁰ At times, other non-captive financial institutions may enter into agreements with manufacturers to provide manufacturer-sponsored customer incentives.

financial institution had more than 5.8% of the market.³¹ The top 100 financial institutions combined accounted for only 68.6%, and conversely 15% of transactions were financed by institutions not among the top 1,000 financial institutions. See Table 1.

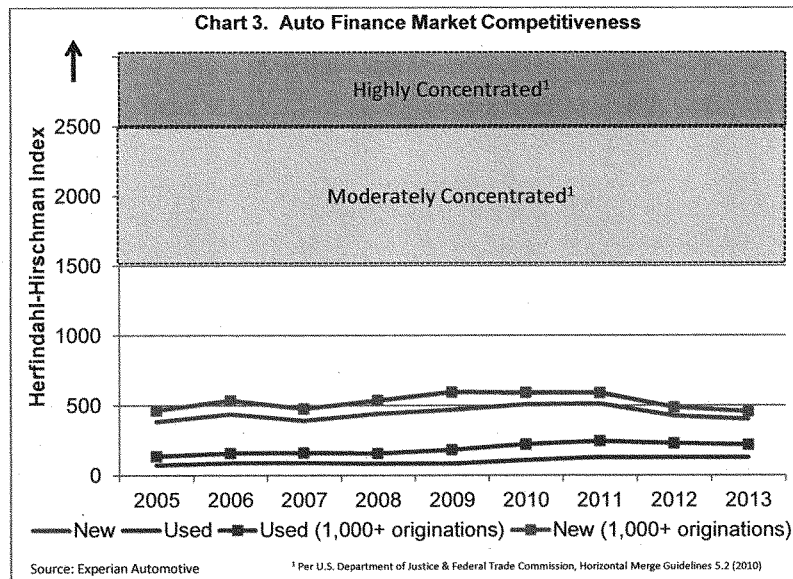
Table 1. 2013 Automotive Finance Market Shares			
Rank	Financial Institutions	Market Share	Cumulative Market Share
1	Wells Fargo Dealer Services	5.8%	5.8%
2	Ally	5.0%	10.7%
3	Chase Auto Finance	4.8%	15.5%
4	Toyota Financial Services	4.6%	20.1%
5	Capital One Auto Finance	3.8%	23.9%
6	American Honda Finance	3.6%	27.4%
7	Ford Motor Credit	3.4%	30.8%
8	Nissan Infiniti Financial Services	2.4%	33.3%
9	Bank of America	2.4%	35.6%
10	Santander Consumer Finance	2.1%	37.7%
	Top 50 Combined	-	63.4%
	Top 100 Combined	-	68.6%
	Top 1,000 Combined	-	84.3%

Source: Experian Automotive

This differs significantly from concentration in the mortgage market, where the 10 largest mortgage originators accounted for over 52% of all originations in 2013.³² A Herfindahl-Hirschman Index (HHI) follows in Chart 3, provided separately for new and used vehicle markets. This provides a measure of market competitiveness by year for the period 2005-2013. Even when financial institutions that financed fewer than 1,000 vehicles are excluded, the HHI indices are well below what the Department of Justice (DOJ) and Federal Trade Commission (FTC) would suggest are even moderately concentrated markets.

³¹ Data provided by Experian Automotive.

³² See Inside Mortgage Finance Publications, *2013 Statistical Annual*, Volume I, Top 100 Mortgage Lenders.



The HHIs calculated here appear to contradict the CFPB's market assessment as reported in their September 17, 2014 *Proposed Larger Participant Rule for Automotive Finance*, in which they note, "According to the Bureau's estimates based on Experian Automotive's AutoCount® database, the proposed automobile financing market includes over five hundred nonbank automobile lenders and is *fairly concentrated* [italics added]."

Financial institutions enter and exit the market with some frequency. Experian Automotive data indicate that approximately 800 financial institutions entered the market after 2005 and each financed more than 1,000 vehicles during the period.³³ The converse is also true. There were approximately 1,000 financial institutions that financed more than 1,000 vehicles during the period, but were no longer in the market by January 2014. This phenomenon was heightened during the financial crisis, when numerous financial institutions tightened credit or exited the automotive

³³ Based on analysis of financial institutions with at least 50 originations between January 2005 and January 2014.

finance space entirely. Conversely, as the vehicle market improved, numerous financial institutions entered, and in some cases re-entered, the market.

3.5. SEGMENT SPECIALIZATION

Financial institutions often focus their activities in select segments of the auto finance market. While some financial institutions may compete in both the direct and indirect channels, it is more common to specialize in one or the other. For example, captive finance companies generally focus on new and certified pre-owned segments and rarely compete in the direct channel. Banks frequently focus on the prime and near-prime segments, while other financial institutions focus on subprime segments. Many non-bank finance company portfolios are comprised heavily of used vehicles. Some financial institutions are regional, while others have national coverage.

To better understand this specialization, we categorized the 50 financial institutions with the largest count of vehicle finance originations with regard to bank/non-bank, captive/non-captive, direct/indirect and credit market segments. We found the following:

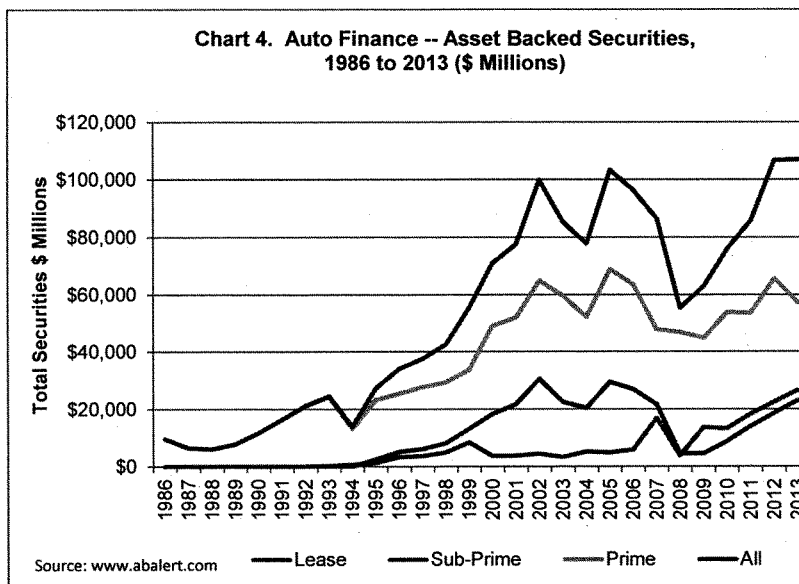
- About half (55%) were banks.
- Approximately one third were captive finance companies or function as such for a manufacturer.
- About 8% were credit unions.
- Six financial institutions had portfolios comprised of more than 75% new vehicles, and all were captive finance companies.
- 28% had portfolios composed of more than 75% used vehicles.
- All 50 participate in the indirect channel, and several, generally banks, also participate in the direct channel.

3.6. SOURCES OF CAPITAL

Financial institutions fund their lending activities through various sources of capital, including private investments, secondary markets (through securitization), deposits, wholesale lending arrangements with other financial institutions, and current capital. Each of these funding sources has an associated cost-of-borrowing and it may vary across sources and financial institutions. Depending on the nature of the financial institution, it may have access to some or all of these capital sources. Many factors contribute to a financial institution's overall cost-of-borrowing, which in turn impacts the rates financial institutions offer dealers through the indirect channel and to consumers through the direct channel. Differences in cost-of-funds may contribute

to the observed specialization across segments of certain financial institutions. For example, banks often focus on the prime market where the ability to offer lower rates is important. Non-depositaries may compensate for higher borrowing costs by developing other advantages, such as strong customer relationships.

An important change in the automotive finance market during the last twenty years was the development of a secondary market for automotive finance asset-backed securities (AF-ABS). When the AF-ABS market originated in the mid-1980s, it was limited to the prime credit segment only. However, by the mid-1990s, AF-ABS markets for subprime and leases began to develop. During the ensuing 20 years, the AF-ABS market has increased seven-fold. See Chart 4.



Secondary markets have provided significant liquidity, particularly to financial institutions operating in the subprime credit segment, expanding credit opportunities in that segment. During the Great Recession, while the residential mortgage backed securities (RMBS) markets virtually ceased to offer new issuances, the AF-ABS market was much less impacted. This is particularly true for the prime AF-ABS issuances. In part, the relative strength of the AF-ABS market reflects the significantly lower delinquency rates observed in the automotive credit markets relative to mortgage mar-

kets during the years 2008-2013. Data published by the Federal Reserve Bank of New York indicates that the 90+ day delinquency rates in auto finance have been less than that for student debt and credit cards since before 2003 and below that for student debt, credit cards, and mortgages since 2008.³⁴

Delinquency rates in mortgage and auto markets have fallen in recent years so that by the first quarter of 2014 they are approximately the same as the levels observed prior to 2008, when mortgage delinquencies were at approximately half the rate of auto delinquencies.

3.7. COMPETITIVE FACTORS

Financial institutions operating in the indirect channel compete with one another on a number of dimensions in order to successfully source contracts from dealers. The indirect channel combines elements of a classic wholesale channel with elements of a commercial finance relationship. By offering dealers varying combinations of the following products and services, financial institutions find competitive advantages in the market and provide the dealer with improved financing options for its customers.

- Processing speed – Faster is better. When an application is submitted to the financial institution by the dealer, the speed with which the financial institution returns the underwriting decision and pricing to the dealer matters.
- Predictability – The dealer's ability to anticipate the financial institution's underwriting and pricing decision matters. This is particularly important on weekends, evenings and holidays when many consumers are shopping for vehicles, but the financial institution may not be processing applications.
- Segment specialization – Concentration in a particularly challenging segment, for example the subprime or used vehicles segments, where dealers may encounter more limited financing options.
- Product range offered to dealer – Offering the dealer a broad range of consumer and commercial financial products: floor-plan financing; construction loans, working capital lines, cash management services, and bank card processing broadens willingness of dealer to continue with financial institution relationship.

³⁴ *Op Cit.*, "Quarterly Report on Household Debt and Credit," FRBNY, August 2014, available at: http://www.newyorkfed.org/householdcredit/2014-q2/data/pdf/HHDC_2014Q2.pdf

- Product range available to consumer – extended warranties, GAP insurance, and other ancillary products, sold to consumers by dealers' F&I departments, broadens options available to consumers.
- Flexibility – The ability of the dealer to request financial institution underwriting or pricing exceptions based on specific facts and circumstances appeals to dealers. For example, counter offers are more likely to help a dealer conclude a deal than are denials of credit.
- Continuity – A dedicated point(s) of contact at the financial institution who can review underwriting and pricing decisions or appeals to decisions enhances continuity from the dealer perspective.
- Prices (buy rates) – All else equal, lower is more competitive.
- Contract Compensation – All else equal, higher compensation makes the financial institution more attractive to a given dealer.
- Risk sharing – Sharing of prepayment and default risk matters, both in terms of percentage and time period. The lower the dealer's share of the risk, the more attractive the financial institution.
- Efficiency – A particular 'efficiency' development in the automotive finance market relates to online credit application networks such as Dealertrack, RouteOne, Open Dealer Exchange and others, which have significant relevance to understanding dealer compensation scenarios.

To expand relationships with dealers and compete in the market place, financial institutions over time have priced these wholesale and commercial products in numerous ways. Some common mechanisms include:

- Establishing dealer loyalty programs where lower buy rates are offered to dealers that meet certain criteria, such as:
 - Dealers that floor-plan with the financial institution.
 - Dealers that have other commercial lines of credit with financial institution.
 - Dealers with exclusive relationships who agree to submit every consumer application to the financial institution to consider.
- Charging lower prices on the floor-plan interest charges to dealers who achieve specified penetration rates.³⁵
- Offering to purchase more of a dealer's non-prime and subprime contracts in exchange for a higher share of dealer prime contracts submitted to the financial institution.

³⁵ In this context the penetration rate is measured from a financial institution's perspective as the percentage of as dealer's total retail contracts assigned to the financial institution.

- Providing the dealers that meet certain criteria with buy rate coupons that can be applied at the dealer's discretion to reduce the buy rate on a specific contract.
- Offering dealers cash management account services related to the funds transferred between the dealer and financial institution.
- Offering the dealer improved risk sharing arrangements in return for increased volume and/or better performing contracts.

That financial institutions focus on various market segments, have different costs-of-funds, compete on multiple dimensions and offer various products is well understood. In subsequent sections, we will consider the effect that these factors have on the analysis of dealer reserve in a fair lending context.

3.7.1. ONLINE CREDIT APPLICATION NETWORKS – THE EFFICIENT AUCTION

In the indirect channel, dealers have always performed the related tasks of collecting consumer information and submitting the completed credit applications to various financial institutions. Traditionally, both tasks could be time consuming. Until more recently, credit applications were often handwritten, incomplete and faxed to the financial institution, and frequently required significant exchange between the dealer and the financial institution. While the information sought by each financial institution had some commonality, there were also considerable differences historically. The process of submitting the credit application was ripe for improved efficiency.

In the early 2000s two companies were formed to offer the dealers an improved processing mechanism. Dealertrack and RouteOne, established in 2001 and 2002, respectively, built online credit application networks, allowing dealers to create credit applications online, obtain consumers' credit bureau reports and submit credit applications to financial institutions. Interestingly, RouteOne was formed by a group of captive finance companies: Ally Financial (then General Motors Acceptance Corp. (GMAC)), Ford Motor Credit Company, TD Auto Finance (then Chrysler Financial), and Toyota Financial Services.

Dealertrack and RouteOne have altered the automotive finance market in a manner analogous to how the Common Application has impacted the college admissions process.³⁶ Prior to the Common App, students were required to laboriously complete individualized college applications. Each one specified its own essay questions

³⁶ <https://www.commonapp.org/Login>

and required highly customized answers. The time necessary to complete each application was a major constraint, dictating the number of colleges to which one applied. Prior to Dealertrack and RouteOne, dealers faced a similar constraint. The automated submission platforms not only solved the time constraint, but also created a real-time market for pricing contracts. As a result, the average number of financial institutions to which a dealer assigns contracts has steadily increased from approximately 7 in 2009 to nearly 10 during the first half of 2014.³⁷ As we will see below, these averages greatly understate the number of financial institutions to which dealers assign contracts.

The participation of financial institutions and dealers in these online networks is significant. RouteOne reports 18,000 dealers and nearly 1,200 financial institutions participate in their network as of November 2014.³⁸ Dealertrack reports more than 1,400 financial institutions utilize their U.S. credit application processing network and more than 20,000 dealers utilize their services and products, resulting in more than 101 million processed transactions during 2013.³⁹

The automated submission platforms have essentially allowed the dealers to conduct an auction for each contract among the financial institutions of their choosing. Arguably, the online credit application networks have shifted market power away from the financial institutions in the direction of the dealers and indirectly to consumers. This process enables dealers to meet or beat competitors' offers and provide the best possible rates and terms to their customers.

3.7.2. DEALERS

The vast majority of vehicle purchases occur at dealers, and all of the vehicle transactions referenced in the CFPB's March 2013 bulletin occurred at dealers. In the U.S. there are franchised dealers and independent dealers. Franchised dealers have agreements with vehicle manufacturers to sell the new vehicles of a specific "make" (i.e., Chevrolet, BMW, or Toyota), and they also sell used vehicles. NADA

³⁷ *Automotive News*, F&I Report, August 13, 2014.

³⁸ <http://www.routeone.com/finance-sources/indirect-auto-financing> accessed on November 13, 2014.

³⁹ Dealertrack 2013 10-K Annual Report, at 6 and 31. Transactions are defined to include revenue-generating transactions processed in the U.S. Dealertrack, Dealertrack Aftermarket Services, Registration and Titling Solutions, Collateral Management Solutions and Dealertrack Canada networks.

reports there were 17,665 franchised dealers in 2013.⁴⁰ Independent dealers sell exclusively used vehicles, and there were approximately 37,026 operating in 2013.⁴¹ The two dealer types share some similarities, as well as some important distinctions.

Similarities

Both franchised and independent dealers actively participate in the auto finance market and provide financing for a large majority of their vehicle-purchasing customers. Neither act as a broker on behalf of the consumer.⁴² While this may be obvious to some, a number of commentators have compared franchised dealers to mortgage brokers, presumably because dealers and mortgage brokers provide financing for consumers in their respective markets. Beyond that apparent similarity, the comparison falls short. Franchised and independent dealers stock inventories of vehicles and, frequently, parts that they sell to consumers.⁴³ They also purchase used vehicles directly from consumers, as well as from wholesale auctions. Both have F&I departments that commonly sell consumers warranty and insurance products and service contracts. Both make investments in facilities, equipment and personnel required to sell and service vehicles.

Franchised and independent dealers combine products and services together in each transaction with a consumer. So while the transaction may begin with the test drive of a new or used vehicle, the transaction is likely to include a bundle of several products and services, including, for example, the service and maintenance of the vehicle post-sale. JD Powers Associates estimates that approximately 79.2% of new

⁴⁰ NADA DATA 2014, at 5 available at: http://www.nada.org/NR/rdonlyres/DF6547D8-C037-4D2E-BD77-A730EBC830EB/0/NADA_Data_2014_05282014.pdf, last accessed September 8, 2014.

⁴¹ 2014 NIADA Used Car Industry Report, at 16., available at: http://www.google.com/url?sa=t&rct=j&q=&esrc=s&frm=1&source=web&cd=3&ved=0CCwQFjAC&url=http%3A%2F%2Fwww.niada.com%2Fuploads%2Fdynamic_areas%2FBroV9gVnZiP633Jla3e2%2F34%2FUCIR_2014_email_version.zip%3F&ei=1tcNVK_vJ8eyuASSsoCgCQ&usg=AFQjCNF3RBibzUCbsDQjBTFFawikcrM7eg&bvm=bv.74649129,d.c2E, last accessed September 8, 2014.

⁴² Arthur P. Baines and Dr. Marsha Courchane, "Automotive Finance: Will dealership finance reserve go the way of mortgage yield spread premiums?" available at: <http://www.crai.com/uploadedFiles/Publications/Automotive-Finance-FE-Whitepaper-0313.pdf>, last accessed September 8, 2014.

⁴³ As of July 1, 2014, franchised dealers had an inventory of 3.55M new vehicle inventories, or approximately 60 days supply, *Automotive News*, July 14, 2014 at 69.

vehicle financing is obtained through the franchised dealer.⁴⁴ Many new vehicle consumers trade in a vehicle as part of the transaction. According to Manheim, a wholesale used-vehicle auction house, "many dealers considered the provision of used vehicle inventory through trade-ins to be the most important function their new vehicle departments played in 2012."⁴⁵ Franchised dealer groups report more than one F&I product included in the average transaction.⁴⁶ For example, Lithia Motors Inc. and Group 1, publically traded companies that owns dealers, reported nearly 43% of vehicle sales included an extended service contract, and 22% of such sales included GAP insurance.⁴⁷ These are consistent with NADA's published service contract penetration rates.

The prices for many of these products and services are subject to negotiation, and both the dealer and consumer have their respective reserve prices.⁴⁸ Consumers negotiating vehicle purchases in today's market have considerably greater information regarding the dealers' reserve prices, relative to the time periods studied in earlier research.⁴⁹ With respect to arranging financing, dealers try to compete with other dealers and with financing offers from the direct channel. From the perspective of the dealer, each transaction represents the potential to earn revenue from the sale of a set of products and services to the consumer. From an economic perspective, the dealer and consumer are concurrently setting the prices for each of the products and services included in the transaction.

For a variety of the reasons discussed above, dealers establish relationships with multiple financial institutions. Dealers require multiple commercial and wholesale financial products and services. The online credit application networks have enhanced dealers' ability to work with multiple financial institutions with regard to arranging consumer financing. The dealers' F&I departments attempt to build relationships with financial institutions that align with the market segments important to the

⁴⁴ Richard Howse, How Different is the Indirect Channel from the Direct Channel? JD Power & Associates, Mar 31, 2008.

⁴⁵ "2013 Used Car Market Report," Manheim, at 13, available at: http://www.niada.com/uploads/dynamic_areas/wp6QIPSw6C83LYM1dGrU/287/Manheim%202013%20UCMR.PDF, last accessed September 8, 2014.

⁴⁶ "Public Group's Dual Focus: Car Sales, F&I," *Automotive News*, August 3, 2011.

⁴⁷ "Public group F&I results strike gold in Q4," *Automotive News*, February 19, 2014 and "Weekly F&I Report," *Automotive News*, November 14, 2012.

⁴⁸ The Reserve price is the maximum/minimum price at which the consumer/dealer is willing to complete the transaction.

⁴⁹ Ian Ayres and Peter Siegelman, "Race and Gender Discrimination in Bargaining for a New Car," *American Economic Review*, Vol. 85, No. 3, June 1995, 304-321.

dealer – new, used, prime, and subprime. While it may be easy to find financial institutions willing to purchase a contract for a new vehicle with a 85% loan-to-value (LTV) and a buyer FICO of 800, the dealer's challenge may be finding a financial institution offering a buy rate low enough to compete with the direct financing the buyer arranged prior to arriving at the dealer. Alternatively, a dealer may struggle to find a financial institution willing to purchase a contract for a buyer with a 550 FICO and recent bankruptcy, unless that dealer has relationships with financial institutions that specialize in the subprime segment. Table 2 provides detail on the number of financial institutions to which dealers in California, Florida and Texas sold contracts.

Table 2. Financial Institutions to which Dealers Assigned Contracts							
State	Measure	Metric	Number of Financial Institutions				Total
			6-10	11-20	21-50	51+	
CA	Dealers	Count	978	937	1,011	568	6,767
		Share	14.5%	13.8%	14.9%	8.4%	100.0%
	Contracts	Count	66,291	139,724	776,107	1,316,934	2,360,406
		Share	2.8%	5.9%	32.9%	55.8%	100.0%
FL	Dealers	Count	769	558	835	221	7,226
		Share	10.6%	7.7%	11.6%	3.1%	100.0%
	Contracts	Count	51,887	85,956	736,595	549,830	1,560,334
		Share	3.3%	5.5%	47.2%	35.2%	100.0%
TX	Dealers	Count	1,635	1,067	985	806	19,510
		Share	8.4%	5.5%	5.0%	4.1%	100.0%
	Contracts	Count	135,702	143,835	389,053	1,572,052	2,474,393
		Share	5.5%	5.8%	15.7%	63.5%	100.0%

Source: Experian Automotive

The results are striking. Dealers have developed extensive networks of financial institutions. More than 80% of contracts were originated by dealers that assigned contracts to more than 20 financial institutions. More than half of all contracts in these states were originated by dealers that assigned contracts to more than 50 different financial institutions. That offers far more potential financing options than the average number of financial relationships per dealers that existed previously.

The degree to which a dealer values the competitive attributes of a given financial institution (see list above) varies according to the specific consumer for which the dealer is attempting to provide financing. The dealer has incentives to identify the lowest available buy rate – in that every dollar saved on the portion of finance charges accruing to the financial institution is potentially retained by the dealer through ei-

ther the dealer reserve subject to the effective cap, or the sale of other products and services in the transaction, or a combination of both. However, the dealer may have additional considerations as it contemplates the financial institution to which it will assign the contract, including whether the financial institution purchases contracts on a recourse or non-recourse basis and the conditions imposed on prepayment or default.

The options available to the dealer vary across financial institutions. Some financial institutions offer the dealer a choice of payment terms, while others do not. Common payments terms include:

- 1) Reduced upfront: under this scenario the dealer receives at contract origination a portion of the dollar value of the hypothetical dealer reserve calculated over the full term of the contract. The dealer generally has prepayment and default risk for anywhere from 90-160 days, after which the dealer is not subject to chargebacks of the dealer reserve. The portion varies across financial institution, but generally ranges from 70-80 percent. The percentage is determined, in part, by market forces and, in part, by the prepayment experience of the financial institution.
- 2) 100 percent upfront with chargebacks: under this scenario the dealer receives at contract origination the full dollar equivalent of the hypothetical dealer reserve calculated over the full term of the contract, and is subject to chargebacks during the life of the contract of the portion of the dealer reserve that does not materialize in the event of prepayment or default.
- 3) As-earned: under this scenario the dealer receives the portion of the consumer's finance charge associated with the dealer reserve each month the contract is in force. If the contract pays off early or defaults, the monthly payments to the dealer cease. In this scenario the dealer carries prepayment and default risk associated with the dealer reserve.

In situations without dealer reserve, the dealer will have an incentive to maximize the level of flat compensation available from the financial institution. The options available to the dealer may vary across financial institutions and commonly include a fixed dollar amount per contract, a fixed percent of the amount financed, or a combination of the two.

A further consideration involves whether or not the dealer needs to find a financial institution willing to purchase its less attractive contracts. In circumstances such as a contract for a buyer with an 800 FICO and a separate contract for a buyer with a 550 FICO, the dealers may attempt to negotiate a deal with a financial institution for as-

signing the 800 FICO contract only if the financial institution agrees to purchase the 550 FICO contract.

There are many other business reasons that impact the dealer's decision to assign the contract to a given financial institution. The process is anything but random.

Differences between franchised and independent dealers

Important differences exist between franchised dealers and independent dealers. These differences emanate from the fact that franchise dealers sell new vehicles, are governed by franchise agreements with the relevant vehicle manufacturers, and are subject to extensive State franchise laws. Franchised dealers frequently have access to manufacturer-sponsored dealer and customer incentives. Franchised dealers are frequently supported by manufacturer-sponsored marketing programs.

Most state law and manufacturer franchise agreements require a franchised dealer to have the capability to service vehicles.⁵⁰ This applies to warranty and recall related servicing as well as general servicing of the vehicle. Franchised dealers must make investments in facilities, tools, computers, etc. required to service vehicles. For example, in 2013, franchised dealers maintained a \$5.47 billion inventory of vehicle replacement parts.⁵¹ Additionally, franchise agreements commonly require franchised dealers to maintain certain levels of customer satisfaction, capitalization, sales penetration, profitability, and facility investment. As such, franchised dealers require a significant amount of capital to fund physical facilities, inventory, payroll, and working capital.

As a result, franchised dealers have different, generally larger and more complex, cost structures than the average independent dealer, but also revenue opportunities not available to the independent dealer. For example, franchised dealers can generate significant revenue and related profits from their parts and service departments, while more than 30% of independent dealers have no service bays.⁵² In our previous research, we have extensively examined the prices charged by the departments

⁵⁰ For a discussion on the history of State Franchise laws see: Francine Lafontaine and Fiona Scott Morton, "State Franchise Laws, Dealer Terminations, and the Auto Crisis," *Journal of Economic Perspectives*, Volume 24, Number 3, Summer 2010, pages 233-250.

⁵¹ *Op Cit.*, NADA DATA 2014, p. 12.

⁵² *Op Cit.*, 2014 NIADA Used Car Industry Report, p. 10.

within franchised dealers, their associated cost structures and resulting profitability or losses.⁵³ We discuss this research in greater detail in subsequent sections.

3.7.3. VEHICLE MANUFACTURERS

In the automotive finance market, vehicle manufacturers have significant impact, primarily resulting from the practice of providing manufacturer-sponsored incentives in the market. They use the incentives for a variety of reasons, such as:

- Reducing consumers' costs to finance vehicle purchases.
- Responding to competitive pressures.
- Reducing vehicle inventory levels at franchised dealers.
- Managing model-year changes.
- Smoothing highly seasonal sales patterns to better reflect the desire for constant production volumes.
- Launching new and/or redesigned vehicle models.
- Managing models through the product life-cycle.

Historically, the dollar volume which manufacturers spend on incentives is large, but varies over time. According to NADA, manufacturer-sponsored incentives in 2013 approached \$2,500 per vehicle, somewhat below the per-unit peak of \$2,932 during 2004.⁵⁴ Manufacturer incentives come in four basic forms: dealer cash, customer cash, finance subsidies and lease subsidies. In 2013 these averaged approximately \$300, \$1,200, \$2,600, and \$4,100, respectively, per vehicle. While customer cash and finance subsidies are visible to consumers, dealer cash generally is not. The effects of this asymmetric information structure have been reported in research studies that find dealers share a portion of dealer cash with customers even though it is generally not visible to them.⁵⁵

Effectively, the manufacturer incentives reduce market prices for the vehicle and financing, which tend to increase demand, relative to levels without incentives. The impact of such incentives is not limited to the specific makes and models on which

⁵³ *Op Cit.*, Baines and Courchane.

⁵⁴ NADA Used Vehicle Price Report: Incentive Analysis and Impact, Q4 2013, at 4 and 7. available at: http://www.nada.com/B2B/Portals/0/assets/pdf/NADA%20UCG_White%20Paper_Incentive%20Analysis%20and%20Impact.pdf, last accessed September 8, 2014.

⁵⁵ *Op Cit.*, Meghan Busse, Florian Zettermeyer, Jorge Silva-Risso, available at: <http://www.nber.org/papers/w10887>

they are available. For example, if Ford puts a 0.9% special finance rate on two-wheel drive F150 pickup trucks in the Northeast, this puts downward pressure on prices of the F150's competitors from other manufacturers. The incentives also put downward pricing pressure on used pickup trucks that consumers consider to be alternatives to a new F150.⁵⁶ To the extent that financial institutions have leased F150's or its competitors in their portfolios, the incentive may impact the profitability (or lack thereof) of those leases.

It is hard to overstate the complexity of these manufacturer-sponsored incentives. The NADA study referenced above examines the intended and unintended impacts of these commonly used incentives. At any point in time, there may be thousands of unique incentives in the market. Commonly, they are model, trim and geographically specific, as in the hypothetical Ford F150 example above. Frequently, the customer cash and finance subsidy incentives are structured as alternatives: cash rebate or special finance rate. Each has different rules with respect to dealer reserve and the financial institution to which the contract is assigned. The cash rebate will be available to the consumer regardless of whether and with whom they finance the vehicle, while the special finance rate will be available only through dealer provided financing in the indirect channel with a specific financial institution -- generally the manufacturer's captive finance arm.

3.7.4. BRINGING IT ALL TOGETHER – TRANSACTIONS

In order to consummate the purchase of a vehicle with indirect financing provided by the dealer, the following steps must be completed:

1. The products and services included in the transaction must be agreed between dealer and consumer.
2. Prices for the included products and services (including the price of vehicle, trade-in value, and price of other F&I products) must be agreed between dealer and consumer.
3. Completed credit application must be submitted by the dealer through online credit application network to one or more financial institutions.
4. Financial institutions must agree to purchase the contract from dealer
5. Financial institutions and dealer must agree on buy rate and other key terms such as LTV and financing term.
6. Contract terms (e.g. amount financed, term and APR) must be agreed between dealer and consumer.

⁵⁶ *Op Cit.*, NADA Used Vehicle Price Report: Incentive Analysis and Impact, Q4 2013, at 2.

7. Dealer must complete documentation requirements and comply with any conditions of the financial institution.
8. Consumer leaves the dealer in a newly purchased vehicle.
9. Dealers must assign contracts to financial institutions and provide the final contract and related documents.
10. The financial institution must compare the actual final contract to what it approved on-line, generally rescoring and re-pricing the contract based on the actual final contract.
11. The dealer and financial institution must finalize compensation to dealer for contract assignment.

In addition to the complexities already discussed, an additional intricacy exists. The steps detailed above need not, and rarely do, occur in this sequence. This particularly applies to spot delivery transactions, in which the dealer and consumer agree upon the terms of the contract and the consumer takes delivery of the vehicle before the financial institution has reviewed the consumer's credit applications. In such transactions, the consumer agrees that the contract may be rescinded if the financial institution does not approve the contract on the terms submitted. Spot deliveries are unique to automotive financing and no corollary exists in mortgage markets. When spot deliveries occur, the dealer reserve is arguably an artifact of the contract rate set by the dealer, rather than the explicit 'marking-up' of a buy rate.

On all contracts, it is only after the dealer provides the final contract documents to the financial institution, that the financial institution validates the contract terms; rescues, re-prices and funds the contract; and finalizes dealer compensation associated with contract assignment. The dealer has important contractual obligations to extinguish its floor plan line of credit and pay the providers of other products and services included in the transaction, such as the provider of an extended service contract.

Given the unique circumstances surrounding these transactions at the dealership, the comparison to mortgage brokers that regulators appear to rely upon is at best superficial. To recognize the absurdity of the comparison, consider the situation in which the house-buying consumer purchased the real estate from an inventory of such properties owned by the broker, while at the same time the broker bought the consumer's current property, sold the consumer a property and casualty insurance policy, a warranty, and service contract on the house, and then eight months after the sale the homeowner called the broker to send someone to paint the house and to fix a leaking roof. Clearly this does not happen in the world of mortgage brokers. It does, however, happen with vehicle purchases for which the dealer and the consumer are simultaneously pricing multiple products and services in a single transac-

tion, while the mortgage broker and the consumer price a single product in a transaction that is dependent on a series of related but separate transactions. Both markets are highly complex, but starkly different.

In Section 5, we analyze and discuss the prices observed in the current market place.

4. FAIR LENDING COMPLIANCE FOR INDIRECT AUTOMOTIVE FINANCE

4.1. BACKGROUND

Indirect auto finance is the focus of renewed and heightened regulatory scrutiny. The CFPB has issued a Bulletin regarding fair lending risk in indirect auto finance, and it purports to be cooperating with the DOJ on ongoing investigations, while coordinating with its sister agencies (the Federal Reserve Board (FRB), the Federal Deposit Insurance Corporation (FDIC) and the Office of the Comptroller of the Currency (OCC)) to develop acceptable methodologies and operations for the examination and supervision of the indirect auto finance market with respect to fair lending risk.

The regulatory authority of the various agencies with respect to fair lending is complicated, sometimes overlapping, and occasionally uneven. Created by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act"), the CFPB was given broad authority over various companies involved in consumer finance activities. This includes bank and non-bank institutions, credit rating agencies, mortgage brokers, loan servicers, etc. Notably, the CFPB's authority does not extend to dealers.⁵⁷ The CFPB has made it a priority to 'even the playing field' with respect to its regulatory authority over certain consumer finance products, including indirect auto finance. For example, prior to the creation of the CFPB, banks were subject to recurring fair lending exams by their respective Federal regulators, however non-banks were not. On October 8, 2014, the CFPB announced a proposed larger participant rule covering the auto finance market, which would extend its examination authority to cover non-banks.⁵⁸ Both the CFPB and DOJ

⁵⁷ The CFPB does have authority over "buy-here pay-here" dealers.

⁵⁸ CFPB authority covers certain financial institutions above specific size thresholds. See 12 U.S.C. Title 12 §5515. Supervision of very large banks, savings associations, and credit unions provides for coverage of (1) an insured depository institution with total assets of more than \$10,000,000,000 and any affiliate thereof; or (2) an insured credit union with total assets of more than \$10,000,000,000 and any affiliate thereof. See

have enforcement authority with respect to fair lending and consumer finance. A memorandum of understanding (MOU), among the federal supervisory agencies provides a framework for the coordination of their enforcement authority in this area.⁵⁹ An MOU also exists between the CFPB and DOJ.⁶⁰ In addition, cooperation is intended between the CFPB and the state banking and financial regulatory agencies.⁶¹

Dealers are subject to regulatory oversight from the FTC, and that agency has brought enforcement actions against a number of dealers during 2014.⁶² This exercise of regulatory authority over financial institutions and dealers has significant relevance to the implementation of standards and methodologies for the examination of fair lending risk in the automotive finance market. While the CFPB has recognized the value provided by dealers who provide retail installment sales contracts for buyers and that dealers deserve fair compensation for that role, the CFPB clearly believes that there is a potential fair lending risk present when dealers can discount the contract rate or when dealer reserves exist.⁶³ The CFPB, however, has no authority to regulate dealer behavior directly. The CFPB does have regulatory authority over many financial institutions to which the dealers assign the finance contract. In the current regulatory landscape, the CFPB vigorously exercises that authority.

This bifurcated regulatory authority requires focus on the examination of indirect automotive finance contracts. For the last ten years, when looking at mortgage originations, regulators required focus on segments (geographic or loan product type) of the market. In fact, even when no disparities were identified at a portfolio level, regulators insisted discrimination could still exist, in, for example, local metropolitan statistical areas (MSA) or at the hands of individual loan officers (retail channel) or wholesale brokers. In the case of indirect auto finance, because the

<https://www.federalregister.gov/articles/2012/05/25/2012-12718/procedural-rules-to-establish-supervisory-authority-over-certain-nonbank-covered-persons-based-on-h-9>

⁵⁹ See

http://files.consumerfinance.gov/f/201206_CFPB_MOU_Supervisory_Coordination.pdf.

⁶⁰ See http://files.consumerfinance.gov/f/201212_cfpb_doj-fair-lending-mou.pdf

⁶¹ See

http://files.consumerfinance.gov/f/201212_cfpb_statement_of_intent_for_sharing_information_with_sbfsr.pdf

⁶² See <http://www.ftc.gov/news-events/media-resources/consumer-finance/auto-marketplace> and <http://www.ftc.gov/news-events/press-releases/2014/01/ftc-announces-sweep-against-10-auto-dealers-for-recent-enforcement-actions>.

⁶³ CFPB Bulletin 2013-02 at 1.

CFPB cannot exercise examination authority over individual dealers, the agency focuses primarily on the portfolio level. The result of this is that even if no individual dealer has any disparities among consumers with whom business is conducted, aggregation within any particular finance company's portfolio across dealers may still lead to a finding of disparate impact.

Evidence of the heightened focus on indirect auto finance can be observed by reviewing three recent issuances from the CFPB: 1) the CFPB Bulletin addressing indirect auto financing and compliance with ECOA, 2) the December 2013 announcement that the CFPB had entered into consent orders with Ally Bank and Ally Financial (Ally) regarding the fair lending implications of allowing dealer discretion in pricing, and 3) the Summer 2014 Supervisory Highlights (Supervisory Highlights) and White Paper on proxy accuracy.⁶⁴

The CFPB takes the position that indirect auto finance companies are liable under ECOA for pricing disparities caused by the financial institution's policies that allow dealers discretion in pricing finance contracts (e.g. establishing the price the dealer will charge for entering the finance contract for the buyer).⁶⁵ The Bulletin makes clear that the CFPB defines indirect auto lenders to include: depository institution, non-bank affiliates of depository institutions, independent nonbanks, and captive nonbanks.⁶⁶ In the Bulletin, the CFPB suggests it would be better to move toward "eliminating dealer discretion to mark up buy rates and fairly compensating dealers using another mechanism, such as a flat fee per transaction, which does not result in discrimination."⁶⁷ The Bulletin appears to parallel the approach to fair lending compliance that has resulted from regulatory enforcement actions against lenders in the mortgage brokerage space.

The CFPB Bulletin identifies features of a strong fair lending compliance management program, including the "regular analysis of loan data in all product areas for potential disparities on a prohibited basis in pricing, underwriting or other aspects of the credit transaction."⁶⁸ The Bulletin makes clear the CFPB's position regarding dealer

⁶⁴ "Using publically available information to proxy for unidentified race and ethnicity: A methodology and assessment," CFPB, Summer 2014, released on September 17, 2014, available at: <http://www.consumerfinance.gov/reports/using-publicly-available-information-to-proxy-for-unidentified-race-and-ethnicity/>, last accessed October 19, 2014.

⁶⁵ *Op Cit*, CFPB Bulletin 2013-02 at 2.

⁶⁶ *Op Cit*, CFPB Bulletin 2013-02 at 1.

⁶⁷ *Op Cit*, CFPB Bulletin 2013-02 at 4.

⁶⁸ *Op Cit*, CFPB Bulletin 2013-02 at 4.

discretion, stating that “an indirect auto lender that permits dealer markup and compensates dealers on that basis may be liable for these policies and practices if they result in disparities on a prohibited basis.”⁶⁹ The CFPB expects quantitative monitoring of the dealer discretion, suggesting the monitoring should be performed for each dealer from which the financial institution purchased contracts and across the aggregated portfolio.

While the CFPB and other regulators are highly focused on one specific component of the cost of credit to the consumer, which is the dealer reserve or ‘markup’ available to dealers,⁷⁰ the examination of this single price in isolation from the rest of the transaction and related market dynamics presents challenges and increases the potential for reaching erroneous conclusions. Understanding the market requires both an explanation and quantification of key aspects of this market.

The Ally consent orders provide some limited insight into the analytical framework through which the CFPB is analyzing this issue; however, neither these consent orders, the Bulletin, or the CFPB White Paper provide specifics on the analytic methods the CFPB uses to estimate disparities, quantify consumer harm or identify harmed consumers or the methods that it might expect financial institutions to use.⁷¹ Based on our knowledge and experience the CFPB’s analytical framework can be summarized in four steps:

1. Develop proxies for race and ethnicity for each contract in the portfolio.
2. Estimate the raw pricing disparities, measured in basis points, across race and ethnicity groups.
3. Quantify the total amount of “harm,” measured in dollars, across the entire portfolio.
4. Identify the contracts associated with harmed consumers.

⁶⁹ *Op Cit*, CFPB Bulletin 2013-02 at 3.

⁷⁰ *Op Cit*, CFPB Bulletin 2013-02 at 2.

⁷¹ The CFPB White Paper addresses only proxy methods. It sheds no light on how the CFPB analyzes proxied contracts and measures disparities.

From public presentations, it is clear that various federal regulators utilize different approaches to address key analytical challenges.⁷² We address these differences in subsequent sections.

4.2. ECOA – DISPARATE IMPACT AND TREATMENT

The Equal Credit Opportunity Act was passed by Congress in 1974 and was implemented through the Federal Reserve Board's Regulation B (Reg B). According to the FRB's Consumer Compliance Handbook, 'The statute requires financial institutions and other firms engaged in the extension of credit to "make credit equally available to all creditworthy consumers without regard to sex or marital status." Moreover, the statute makes it unlawful for "any creditor to discriminate against any applicant with respect to any aspect of a credit transaction (1) on the basis of race, color, religion, national origin, sex or marital status, or age (provided the applicant has the capacity to contract); (2) because all or part of the applicant's income derives from any public assistance program; or (3) because the applicant has in good faith exercised any right under the Consumer Credit Protection Act.'" In keeping with the broad reach of the prohibition, the regulation covers creditor activities before, during, and after the extension of credit.'⁷³

Except with respect to dealers and other specified creditors, the Dodd-Frank Act transferred the implementation authority over Regulation B from the FRB to the CFPB and granted rule-making authority under ECOA to the CFPB and, with respect to entities within its jurisdiction, granted authority to the CFPB to supervise for and enforce compliance with ECOA and its implementing regulations.⁷⁴

Regulatory agencies, including the CFPB, have generally defined three methods of proving lending discrimination under ECOA. The 1994 Interagency Task Force on Fair Lending, which was adopted by all of the relevant federal regulatory agencies, defines the methods as follows:

⁷² See "Indirect Auto Lending: Fair Lending Considerations," Outlook Live Webinar, August 6, 2013, Consumer Financial Protection Bureau, Federal Reserve Board and U.S. Department of Justice, available at: <http://www.philadelphiafed.org/bank-resources/publications/consumer-compliance-outlook/outlook-live/2013/indirect-auto-lending.cfm>, last accessed September 8, 2014.

⁷³ http://www.federalreserve.gov/boarddocs/supmanual/cch/fair_lend_reg_b.pdf, last accessed September 8, 2014.

⁷⁴ http://files.consumerfinance.gov/f/201306_cfpb_laws-and-regulations_ecoa-combined-june-2013.pdf, last accessed September 8, 2014.

- "Overt evidence of discrimination," when a lender blatantly discriminates on a prohibited basis;
- Evidence of "disparate treatment," when a lender treats applicants differently based on one of the prohibited factors; and
- Evidence of "disparate impact," when a lender applies a practice uniformly to all applicants but the practice has a discriminatory effect on a prohibited basis and is not justified by business necessity.⁷⁵

In an April 2012 bulletin, the CFPB reaffirmed its view that the legal doctrine of disparate impact remains applicable as the CFPB exercises its supervision and enforcement authority to enforce compliance with ECOA and Reg B.⁷⁶

Examination for evidence of disparate impact, sometimes referred to as the "effects test," requires application of a multiple-step test.⁷⁷ A thorough understanding of the disparate impact method is absolutely essential to understand the current regulatory activity related to dealer pricing discretion. The Federal Financial Institution Regulatory Guidance 09-06 explained the disparate impact test as follows.

When a lender applies a racially or otherwise neutral policy or practice equally to all credit applicants, but the policy or practice disproportionately excludes or burdens certain persons on a prohibited basis, the policy or practice is described as having a "disparate impact."

The fact that a policy or practice creates a disparity on a prohibited basis is not alone proof of a violation. When an Agency finds that a lender's policy or practice has a disparate impact, the next step is to seek to determine whether the policy or practice is justified by "business necessity." The justification must be manifest and may not be hypothetical or speculative. Factors that may be relevant to the justification could include cost and profitability. Even if a policy or practice that has a disparate impact on a prohibited basis can be justified by business necessity, it still may be found to be in violation if an alternative policy or practice could serve the same purpose with less discriminatory effect. Finally, evidence of discriminatory intent is not necessary to es-

⁷⁵ See guidance for the Federal Financial Institution Examination Council members at http://www.federalreserve.gov/boarddocs/caletters/2009/0906/09-06_attachment.pdf ("FFIEC 09-06"), last accessed September 8, 2014.

⁷⁶ CFPB Bulletin 2012-04 (Fair Lending), available at: http://files.consumerfinance.gov/f/201404_cfpb_bulletin_lending_discrimination.pdf, last accessed September 8, 2014.

⁷⁷ *Ibid*, CFPB Bulletin 2012-04 (Fair Lending).

establish that a lender's adoption or implementation of a policy of practice that has a disparate impact is a violation of the FHAct or ECOA.⁷⁸

While there is debate about the legal doctrine of disparate impact and its applicability under ECOA, clearly the intent of the CFPB, DOJ, and private plaintiffs is to apply the doctrine to consumer lending.⁷⁹

In indirect auto finance in the late 1990s and early 2000s, private plaintiffs sued numerous financial institutions under the disparate impact legal doctrine, alleging that their policies regarding dealer reserve violated ECOA. These litigations were settled, generally with defendants agreeing to put in place additional controls regarding dealer reserves.⁸⁰ Generally, the agreed caps were progressive by term, whereby longer terms were subject to lower caps.

In 2007, two independent dealers, Springfield Ford Inc. (Springfield) and Pacifico Ford Inc. (Pacifico), entered separate Consent Orders with the DOJ to resolve claims that they violated ECOA with respect to the dealer reserves charged to African American consumers.⁸¹ The dealers agreed to start all dealer reserve negotiations from the same starting point, measured in basis points (bps), and deviate downward "only for a good faith, competitive reason that is consistent with ECOA."⁸² The orders define seven reasons that are consistent with ECOA, to include:

- A lower cap imposed by the financial institution for the particular transaction.
- A constraint on the customer's ability to satisfy monthly payment requirements.
- A statement by the customer that he or she has access to an equal or more favorable offer from another dealer or financial institution.
- A special promotional offer extended to all customers on the same terms.

⁷⁸ *Op Cit*, FFIEC 09-06 at 6.

⁷⁹ The Supreme Court (The Court) recently agreed to hear a case regarding whether disparate impact theory is applicable under the Fair Housing Act, which as noted in the FFIR guidance, is structured similarly to ECOA. It is the third such case the Court has agreed to hear, however, as the first two cases settled prior to The Court rendering a decision.

⁸⁰ <http://www.nclc.org/litigation/case-index-closed-cases.html>, last accessed September 8, 2014.

⁸¹ http://www.justice.gov/opa/pr/2007/August/07_crt_639.html, last accessed September 8, 2014.

⁸² http://www.justice.gov/crt/about/hce/documents/pacifico_order.pdf, at 4, and http://www.justice.gov/crt/about/hce/documents/springfield_order.pdf, at 4, last accessed September 8, 2014.

November 19, 2014

American Financial Services Association

- The fact that a particular transaction is eligible for subvented interest rates.
- The fact that the transaction is eligible for Springfield/Pacifico Ford's employee incentive program.
- Documented inventory reduction considerations related to specific vehicles.

These seven reasons recognize many of the economic and business realities described above, and their causal impact on observed dealer reserve prices.

4.3. FAIR LENDING AND DEALER RESERVE

During the last two years, the CFPB has increased its scrutiny on fair lending with respect to indirect automotive finance. It is not always clear whether the agency is applying a disparate treatment test or a disparate impact test during its examinations. It is also unclear whether or not model controls that might impact dealer reserve are allowed during the consideration of these matters.

The CFPB's Bulletin, subsequent public comments and the Ally consent orders strongly suggest that the CFPB and DOJ believe that their analysis can determine evidence of disparate impact by comparing average differences on dealer reserve between minority and non-Hispanic white consumers, in the absence of explanatory factors, competitive factors, or dealer specific factors that might impact the level of dealer reserve. The CFPB's Supervisory Highlights serves to further suggest the CFPB believes a disparate impact theory applies to dealer reserve.

"Findings of disparities in discretionary markup in an indirect auto lender's portfolio typically constitute a pattern or practice of discrimination if the disparities cannot be justified by a 'legitimate business need that cannot reasonably be achieved as well by means that are less disparate in their impact.'"⁸³

At a CFPB-sponsored Automotive Finance Forum in November of 2013, senior representatives of the CFPB asserted that their analyses have identified circumstances where "similarly-situated" minority buyers paid higher dealer reserves. In the Ally consent order, the CFPB reported that they were unpersuaded by Ally's rationale for including controls in the analysis, stating that "Respondents failed to provide adequate evidence that additional variables appropriately reflected legitimate business needs." Consequently, with the exception of avoiding any comparison of consumers who received subvented interest rates to those who did not receive subvented interest

⁸³ CFPB Supervisory Highlights, Summer 2014, released September 17, 2014, at 13-14, available at: http://files.consumerfinance.gov/f/201405_cfpb_supervisory-highlights-spring-2014.pdf, last accessed October 22, 2014.

rates, the disparities reported appear to be raw differences.⁸⁴ This implies that all of the consumers being compared were 'similarly situated' even though no attempt was made to ensure that they were similarly situated.

Perhaps the CFPB's approach reflects the statutory limits of its authority, whereby it has broad supervisory and enforcement authority of financial institutions, but no authority over dealers engaged in indirect financing.⁸⁵ However, in its Bulletin, the CFPB describes the relevant policy as follows, "...auto lenders have policies that allow auto dealers to mark up lender-established buy rates that compensate dealers for those markups in the form of reserve..."⁸⁶ The CFPB goes on, "Because of the incentives these create, and the discretion they permit, there is a significant risk that they will result in pricing disparities on the basis of race, national origin and potentially other prohibited bases."⁸⁷

The CFPB's description makes clear that an accurate analysis of pricing disparities, unlike a traditional disparate impact fair lending test, critically hinges on an assessment of how dealers are exercising the discretion afforded them under these policies. Key to their argument is the phrase "the discretion they permit." This is consistent with the DOJ consent orders with Pacifico and Springfield, which recognized that numerous economic and business realities at the dealer-level have a causal outcome on dealer reserves.

This approach has some parallels in two areas commonly analyzed in the fair lending context -- underwriting and traditional risk-based pricing. In such analyses, it would be common to estimate raw denial rates two or more times higher for some minority applicants relative to non-minority applicants. In our experience, this fact alone would rarely generate regulatory concern. Further, it is common for these areas to involve varying degrees of judgment or discretion, from exceptions to underwriting decisions to adjustments to par pricing, and the mere presence of discretion would not result in raw disparities becoming the metric of concern. It is understood that differences in raw average denial rates generally reflect differences between minority and non-minority applicants in average wealth accumulation, income and credit worthiness as measured by commonly used credit scores, down payments and re-

⁸⁴ See http://files.consumerfinance.gov/f/201312_cfpb_consent-order_ally.pdf, last accessed September 8, 2014.

⁸⁵ The CFPB has authority with respect to 'buy-here, pay-here' dealers.

⁸⁶ CFPB Bulletin 2013-02 at 2.

⁸⁷ CFPB Bulletin 2013-02 at 1.

serves.⁸⁸ It is only after the consideration of these and other relevant and non-prohibited explanatory factors that estimated differences on a prohibited basis give rise to regulatory concern. Rarely also would fair lending examinations of pricing decisions proceed without control variables needed to reflect similar products and consumers.

However, this parallel extends only so far. In underwriting and traditional risk-based pricing, generally the financial institution alone makes the final decisions, and they are generally guided by extensive policies, procedures and practices that govern the use of automated models and discretion. In the case of dealer reserve, it is the dealer who exercises the discretion in the context of a transaction with multiple prices simultaneously negotiated and where the relevant policies, procedures, practices and business realities are primarily those of the dealers. The analysis is further complicated because, as discussed above, the dealer commonly has the option to assign the contract to one of numerous financial institutions, each with potentially different policies governing dealer reserve discretion. Further, financial institutions rarely afford dealers unbridled discretion. Rather, dealer reserve is commonly subject to caps, which frequently vary by term (longer terms, lower caps), credit quality (lower credit tiers, lower caps) or specific models and geographies in the context of manufacturer-sponsored subvention programs (generally zero dealer reserve). The most prevalent caps are 250 bps on terms 60 months or less and 200 bps on terms longer than 60 months.^{89, 90} As average contract lengths have increased, a larger share of contracts is subject to the relatively common 200 bps cap. These trends are observed in the CRA Contract Data as reported in Appendix I. Additionally, there are variations in the complexity of these cap structures.

The complex, multi-party nature of these transactions among consumers, dealers, vehicle manufacturers and multiple financial institutions gives rise to a number of challenges to the assessment of dealer discretionary pricing, at either the dealer level or the financial institution portfolio level.

Challenges include:

⁸⁸ See Squires, Gregory D. and Charis E. Kubrin, 2006, *Privileged Places: Race, Residence and the Structure of Opportunity*, Lynn Rienner Publishers, Inc., Boulder, CO.

⁸⁹ *Op. Cit.*, CFPB Supervisory Highlights, 2014.

⁹⁰ The settlements reached in the private litigations on dealer reserve established caps that differ by length of contract: 250 bps on terms less than 61 months, and 200 bps on terms longer than 60 months.

- The race, ethnicity and gender of the vehicle buyer(s) are unknown to the financial institution and its regulators, as financial institutions are prohibited from collecting this information in the automotive finance market.
- The vehicle purchase transaction includes complex sequential decisions made by both the dealer and consumer, which result from the components of the vehicle purchase (new, used, trade-in, options, insurance, warranties, servicing). Given these complexities and the resultant pricing dynamics, attempts to evaluate the cost of financing in isolation from the prices of other products and services accompanying the vehicle purchase, presents many challenges and increases the potential for drawing erroneous conclusions.⁹¹
- Many dealer specific, supply-side, factors impact the dealer's pricing and profitability on the vehicle purchase transactions and thus the amount of dealer reserve. While the DOJ has recognized that several of these factors may have a direct impact on dealer reserves, these factors are generally unknown to the financial institution and regulators.⁹²
- Many consumer specific, demand-side, factors impact the consumer's willingness and/or ability to purchase the vehicle and/or associated products and services and may also impact the amount of dealer reserve. Here again, the DOJ has recognized that several of these factors may have a direct impact on dealer reserves; however, these factors are generally unknown to the financial institution and regulators.⁹³
- Differences in pricing strategies across dealers may, when aggregated to financial institution's portfolio level, create the appearance of differential pricing on a prohibited basis when none exists.
- Finally, given the highly competitive nature of automotive finance, each financial institution observes the pricing of only a subset of a dealer's contract portfolio, rather than that of the entire dealer portfolio. The assignment of contracts is not random, and may reflect the dealer's desire to maximize reserve for a given buy rate, which suggests that conclusions about dealer compensation patterns cannot be ascertained from the analysis of the con-

⁹¹ In previous research, the authors have extensively examined this pricing dynamic and found that dealers price these transactions, on average, at a level that does not generate net profits. See Baines and Courchane, 2014.

⁹² See DOJ Consent Orders in Pacifico and Springfield at: http://www.justice.gov/crt/about/hce/documents/pacifico_order.pdf, at 4, and http://www.justice.gov/crt/about/hce/documents/springfield_order.pdf, at 4, last accessed September 8, 2014.

⁹³ *Ibid*, DOJ Consent Orders in Pacifico and Springfield

tracts assigned to a given individual financial institution but would require focus on the individual dealers' full books of business.

4.4. IDENTIFYING RACE AND ETHNICITY FOR VEHICLE PURCHASES

Financial institutions generally are prohibited from collecting race/ethnicity information in the automotive finance market. Fair lending analysis requires the construct of proxies. Proxy methods have been used for non-HMDA reportable loan products since the mid-1990s. This includes, but is not limited to home equity loans, direct and indirect automotive finance, credit cards, student loans and small business loans. In these areas, race, ethnicity and gender proxies are commonly used to analyze general fair lending compliance issues related to underwriting of credit applications and pricing of the originated products. During this time, regulatory authorities and the financial institutions over which they have authority have used various methods based on publicly available information from the Census Bureau to proxy these attributes. The most commonly used proxy method simply relied on the protected class share of population in a Census tract. For example, a majority-minority Census tract has a population that is more than 50% minority.

The use of a proxy necessarily inserts uncertainty into the identification of a consumer's race or ethnicity or gender as all current methodologies depend upon the use of probabilistic measures to assign race/ethnicity. The use of Census Bureau data to develop race and ethnicity proxies raises a number of questions concerning the accuracy of the proxies for consumers with different race/ethnicity indicators, potential bias in the measures, and potential mitigations for the biases, if any. Prior to addressing those questions, the Census Bureau data metrics are discussed.

Census Bureau population counts are available by race/ethnicity for specific geographies.⁹⁴ The Census Bureau reports population counts at various geographic levels, which are, from largest to smallest: State, county, tract, block group and block. In the 2010 Census there were 73,057 tracts, 217,740 block groups and 11,078,297 blocks.⁹⁵ As such, the average population of a tract was approximately 4,240, while the average population of a block was just 29.⁹⁶ As an example, the

⁹⁴ http://www2.census.gov/census_2010, last accessed September 8, 2014.

⁹⁵ <https://www.census.gov/geo/maps-data/data/tallies/tractblock.html>, last accessed on November 13, 2014.

⁹⁶ Based on a 2010 total U.S. population of 308.4M and excluding the water only tracts and blocks.

Census Bureau counts of the 18 and older population (18+) and the associated shares for a tract in Washington, DC are presented in Table 3.⁹⁷

Table 3. Population, 18 and Over, Tract 0050.02 - Washington, DC				
Race/Ethnicity	Tract Counts	Intra- Tract Shares	U.S. 18+ Population Count	Share of U.S.
Hispanic	1,340	24.5%	36,138,485	0.0037%
African American	1,008	18.4%	27,327,470	0.0037%
Asian/Pacific Islander	307	5.6%	11,637,514	0.0026%
American Indian	15	0.3%	1,600,043	0.0009%
White	2,693	49.2%	157,123,289	0.0017%
2+ Races	109	2.0%	3,177,961	0.0034%
Total	5,472	100.0%	237,004,762	0.0023%

Source: Census Bureau

The 18+ Hispanic population of the tract is 1,340, which represents 24.5% of the total tract 18+ population and .0037% of the U.S., Hispanic 18+ population.

In the past two years, the BISG methodology has been used by the CFPB and DOJ to assign race/ethnicity, when unknown.⁹⁸ To the geographic population information, this methodology adds information on the likelihood of race/ethnicity based on surname, using the Census Bureau surname list. This list was tabulated from the 2000 Census and includes 151,671 surnames that occurred 100 or more times.⁹⁹ For each surname the Census Bureau calculates six mutually exclusive racial and

⁹⁷ As used in this document, "African American" includes "Black or African American," "Hispanic" includes "Hispanic or Latino," and "Asian" includes both "Asian" and "Native Hawaiian or Other Pacific Islander," as defined by the Office of Management and Budget. See Revisions to the Standards for the Classification of Federal Data on Race and Ethnicity (October 30, 1997), available at http://www.whitehouse.gov/omb/fedreg_1997standards. Last accessed on November 6, 2014.

⁹⁸ This methodology was not communicated, as far as can be determined from public sources, to any financial institutions before Spring 2013.

⁹⁹ In order to protect confidentiality of the race/ethnicity of specific individuals, the Census Bureau reports names that occur 100 times or more and do not report cells with 1 – 4 observations. See "Demographic Aspects of Surnames from Census 2000," David L. Word, Charles D. Coleman, Robert Nunziata and Robert Kominski, available at: <http://www.census.gov/genalogy/www/data/2000surnames/surnames.pdf>, last accessed September 8, 2014.

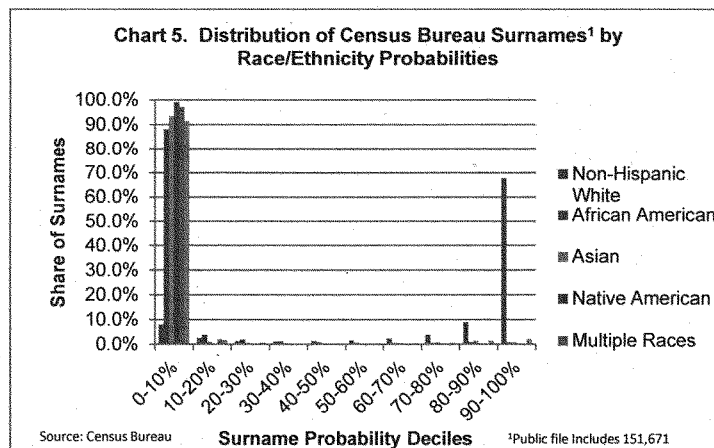
ethnic group proportions. These proportions generally sum to 100% for each surname. For example, Table 4 reports the Census Bureau race/ethnicity proportions for the surname "Johnson."

Table 4. Race/Ethnicity Probabilities for Surname "Johnson"	
Race/Ethnicity	Share
Hispanic	1.5%
African American	33.8%
Asian/Pacific Islander	0.4%
American Indian	0.9%
White	61.6%
2+ Races	1.8%
Total	100.0%

Source: Census Bureau

The distribution of names by race/ethnicity probabilities are presented in Chart 5. The interpretation of the columns is better understood through examples.

- 88.2% of the surnames included in the Census Bureau list are reported to have African American probabilities less than or equal to 10%.
- Conversely, 0.08% of the surnames are reported to have African American probabilities greater than 90%.
- 67.8% of the surnames are reported to have non-Hispanic white probabilities greater than 90%.



The surname list has not been updated based on 2010 Census results. This means that the information does not reflect the degree to which any of these surname probabilities have changed over the past 14 years. Given the significant demographic changes observed in the last 14 years, the changes could be meaningful.

There are many ways these two data sources can be used, individually or in combination, to develop race/ethnicity proxies. In the current regulatory environment, various regulatory agencies have suggested approaches they believe appropriate for the institutions over which they have authority. The basic question for which the data are used is to determine the probabilities that a random person from a given tract with a given surname belongs to specific race/ethnicity groups. The information must, due to limitations of the data, reflect the general population that is 18 or older, and not the population of persons who may be interested in automobile purchase and financing. To the extent that the purchase and finance decisions are not random with respect to race/ethnicity, using these measures may impart unknown bias. In the next section, the validity of this assumption is assessed.

4.4.1. VEHICLE PURCHASES BY RACE/ETHNICITY SHARES

The race/ethnicity of financed vehicle purchases are not captured or known. However there are two well-known consumer surveys that shed some light on this question. They are the American Community Survey (ACS) and the Consumer Expenditure Survey (CEX).

The Census Bureau conducts the ACS as a "nationwide survey that collects and produces information on demographic, social, economic and housing characteristics about our nation's population every year."¹⁰⁰ The Census Bureau mails survey questionnaires to approximately 295,000 household each month.¹⁰¹ Policy makers and planners at Federal, State and local governments, as well as businesses and academics all use the collected data.

The data collected in ACS include detailed information on vehicle ownership by race/ethnicity and geography. Table 5 below reports the level of vehicle ownership by race/ethnicity nationally for 2012. A number of important patterns can be observed. First, Americans broadly own vehicles – approximately 60% of

¹⁰⁰ American Community Survey Information Guide, U.S. Census Bureau, http://www.census.gov/acs/www/Downloads/ACS_Information_Guide.pdf, last accessed September 8, 2014.

¹⁰¹ *Ibid*, at 8.

households have two or more vehicles, and 1 in 5 households have 3 or more vehicles. However there are notable differences by race/ethnicity. Minority households are significantly more likely relative to white households not to own any vehicle. The ACS reports 11.2%, 19.0% and 10.2% of Hispanic, African American and Asian households, respectively, did not own a vehicle during 2012, as compared to 6.8% of non-Hispanic white households. At the other end of the continuum, Hispanic and Asian households are just about as likely as white households to own more than 2 vehicles, while African American households are 38% less likely than white households to own more than 2 vehicles.

Table 5. National Household Vehicle Ownership by Race/Ethnicity - 2012				
Vehicles per Household	Hispanic	Black	Asian	White
% of Household with No Vehicle	11.2%	19.0%	10.2%	6.8%
% of Household with 1 Vehicle	31.4%	41.6%	29.2%	33.5%
% of Household with 2 Vehicles	37.1%	26.8%	40.1%	39.4%
% of Household with >2 Vehicles	20.4%	12.6%	20.6%	20.4%

Source: Census Bureau, American Community Survey

Disaggregation of these results by state, (see Appendix C for state-level vehicle ownership by race/ethnicity, 2010-2012) shows that while these general patterns observed between minority and white households are consistent, there are wide differences in vehicle ownership from state to state. For example, during 2012 in New York 49%, 47%, 41% and 19% of Hispanic, Black, Asian and white households, respectively, had no vehicle, while in Utah the shares are 5%, 9%, 6% and 4%, respectively. These variations are not surprising and likely result from numerous factors, including urban/rural mix, availability of public transportation, differences in cost of vehicle ownership and other economic factors. This wide variation across states suggests a relationship between areas of low vehicle ownership and race/ethnicity.

The ACS survey data do have limitations. A household can own a vehicle, without financing the purchase, as occurred for about 41% of all vehicle transactions in 2013.¹⁰² The vast majority of these non-financed vehicle transactions are relatively lower-cost used vehicles which may suit a buyer due to the buyer's own financial capacity, use as a non-primary vehicle, use for a young driver, etc. The ACS data do not permit the identification of vehicles owned as the result of a financed transaction.

¹⁰² Based on Experian Automotive analysis of vehicle titles from 2013. $1 - (((15.9M * .79) + (42M * .52)) / (15.9M + 42M))$

Fortunately, the Consumer Expenditure Survey allows us to identify by race/ethnicity households that financed vehicle transactions. The CEX data are collected quarterly for the Bureau of Labor Statistics (BLS) by the Census Bureau.¹⁰³ According to BLS, "it is used by economic policymakers examining the impact of policy changes on economic groups, by the Census Bureau as the source of thresholds for the Supplemental Poverty Measure, by businesses and academic researchers studying consumer's spending habits and trends, by other Federal agencies, and, perhaps most importantly, to regularly revise the Consumer Price Index market basket of goods and services and their relative importance."¹⁰⁴

Table 6 below uses CEX data and reports the share of financed vehicle purchases by race/ethnicity, separating new and used transactions for 2010 - 2012.

Table 6. Household Population Shares Compared to Financed Vehicle Purchase Rates by Race/Ethnicity				
Race/Ethnicity	Household/Purchase	2012	2011	2010
African American	All Households	13.0%	12.7%	12.6%
	Financed New Vehicle	6.0%	6.0%	8.3%
	Financed Used Vehicle	14.4%	11.5%	10.2%
Hispanic	All Households	13.7%	13.6%	13.2%
	Financed New Vehicle	11.9%	11.9%	11.5%
	Financed Used Vehicle	15.6%	16.0%	14.6%
Asian	All Households	4.8%	4.6%	4.6%
	Financed New Vehicle	5.7%	6.8%	3.3%
	Financed Used Vehicle	2.9%	4.2%	3.1%
Non-Hispanic White	All Households	67.4%	68.1%	68.4%
	Financed New Vehicle	75.3%	74.2%	75.6%
	Financed Used Vehicle	65.1%	67.8%	69.7%

Source: Consumer Expenditure Survey, Q1-2010 to Q1-2013.

These data reveal an important distinction between new and used transactions. African American and Hispanic households appear to finance new vehicles at lower rates than their population shares would suggest. These comparisons are made at the national level, and CEX data does not allow for comparison within smaller geographies, thus we cannot determine from CEX whether these results vary by geography.

¹⁰³ <http://www.bls.gov/ce/>, last accessed September 8, 2014.

¹⁰⁴ <http://www.bls.gov/ce/>, last accessed September 8, 2014.

Taken together, the ACS and CEX data suggest that minority groups do not purchase or finance vehicles in proportion to their shares of the overall population. This appears to be most pronounced with respect to African American and Hispanic households and new vehicle transactions. Thus, the use of proxies built upon geographic and surname population shares may lead to the overestimation of minority probabilities associated with any given vehicle contract, assigning a contract to a minority buyer when the buyer is not a minority. In subsequent sections we quantify the extent to which this overestimation occurs and discuss the implications.

4.4.2. SPECIFIC PROXY METHODS

The CFPB advocates the use of BISG as its proxy method of choice, and began directing practitioners to a paper by researchers at Rand that analyzes the accuracy of BISG.¹⁰⁵ On September 17, 2014, the CFPB released its White Paper assessing the accuracy of BISG relative to other proxy methods. We share the CFPB's view that it is critically important to assess BISG's accuracy and applicability for proxying race/ethnicity for consumers making indirect auto finance purchases. However, such testing should not be limited to an assessment of BISG's performance relative to surname or geography only proxies. More comprehensive testing is required to determine BISG's objective reliability, and we do so in this section.

BISG differs substantively from other commonly used proxy methods, and requires complex statistical computer coding. It also requires the practitioner to make several assumptions, many of which are not described within the Rand article. Among the required assumptions that must be made for the proxy method are the following:

- The geographic level: tract, block group or block.
- The population: all or 18+.
- Options for when an address cannot be accurately mapped to the desired geographic level.
- Options for geographies with 'masked' population counts.
- Treatment of surnames that do not appear on the Census Bureau surname list – for example, dropping them entirely or assigning population shares.
- Treatment of hyphenated surnames, such as Pierre-Louis.
- Treatment of compound surnames, such as De La Torre.
- Treatment of surnames where the proportions do not sum to 100.

¹⁰⁵ Elliott, Marc N. et al, "Using the Census Bureau's Surname List to Improve Estimates of Race Ethnicity and Associated Disparities," *Health Serv Outcomes Res Method* (2009) 9:69–83.

- Assignment of race/ethnicity for contracts with more than one surname (buyer and co-buyer) and/or more than one address.

The CFPB's White Paper describes its implementation of BISG and was accompanied by programming code that reports many, but not all, of the CFPB's assumptions. Appendix D describes the assumptions we made to implement BISG for the purposes of this study and Appendix E contrasts them with the CFPB's assumptions.¹⁰⁶ In both implementations, BISG creates a vector of six race/ethnicity probabilities for each surname and address combination - Hispanic, African American, Asian/Pacific Islander, American Indian, White non-Hispanic, and two or more races. The six probabilities sum to 100%, but for technical reasons it is extremely unlikely that any single probability will equal 100%. BISG does not use the intra-tract population shares. Rather, it uses the share of the U.S. population of each race/ethnicity group residing within the tract. For example, combining the Census Bureau data reported above for a Washington, DC tract and the surname 'Johnson,' we calculate the following BISG vector.

Table 7. BISG Calculation Example			
Race/Ethnicity	Surname "Johnson"	Tract 0050.02 Wash, DC	BISG Probability
Hispanic	1.5%	0.0037%	2.3%
African American	33.8%	0.0037%	51.1%
Asian/PI	0.4%	0.0026%	0.5%
American Indian	0.9%	0.0009%	0.3%
White	61.6%	0.0017%	43.2%
2+ Races	1.8%	0.0034%	2.6%
Total	100.0%	0.0023%	100.0%

Source: Census Bureau

It is generally the case that all six probabilities will be populated by a number greater than zero and less than 100. In those situations where a tract has no members of a given race/ethnicity group, the BISG probability associated with that group will be zero for all addresses in the tract, regardless of surname. Likewise if none of the

¹⁰⁶ In our collective experience, proxies have generally been calculated with tract-level populations, rather than block group or block, and we will use tract-level populations here, unless otherwise noted. While beyond the scope of this paper, there is reason to believe that proxies based on the smaller geographic areas are subject to relatively larger, non-random errors that increase as the time period under review becomes progressively farther away from the decennial census.

individuals with a given surname belong to a particular race/ethnicity group, the BISG probability associated with that group will be zero for all individuals with that surname, regardless of the tract in which they reside.

The above example offers a number of observations. While 61.6% of people with the surname Johnson reported to the Census Bureau that they were white, the BISG probability associated with white is only 43.2% because a lower share, 0.0017%, of the U.S. white population resides in this tract relative to the corresponding African American share. This contrasts with the intra-tract white population share of 49.2%. The opposite occurs with respect to African American. The BISG probability associated with African American is 51.1% despite only 33.8% of people with the surname Johnson having self-reported to be African American. This is because a relatively higher share, .0037%, of the U.S. African American population resides in this tract.

As illustrated, the BISG methodology takes two separate pieces of information, combining them to adjust the probabilities associated with a race/ethnicity group beyond what would be expected using either data point individually. This additional impact will be referred to as 'lift.' In Appendix F we provide tables that report the average BISG probabilities observed for various combinations of surname probabilities and intra-tract population shares. These tables are based on the BISG probabilities in the CRA Contract Data. For example, the average African American BISG probability is 83.5%, when the underlying surname probabilities and intra-tract shares are between 40-50%.

Finally, to understand the implications of the testing reported in the next section, it is essential to understand how these probabilities are used in fair lending testing. There are two primary methodologies used for defining the proxy – threshold-based methods and continuous methods.

In threshold-based approaches, a race/ethnicity probability threshold is established, for example 75%. All consumers with a categorical probability exceeding the threshold are assigned to that group. In this way, consumers (and their contracts) can be classified into groups of 'likely' African Americans, Hispanics, Asians, non-Hispanic whites. Prices and other attributes can then be analyzed across the groups.

In the continuous methodology, contracts are not assigned to a definitive group, but rather each consumer is assigned a vector of probabilities and each contract contributes to the overall analysis proportionate with these probabilities. An example may be illustrative. Let there be 10 contracts from 10 individual buyers. Each buyer has been defined the vector of probabilities of 60% white, 20% African

American and 20% Hispanic. Under the continuous approach, each contract would be weighted 60% white, 20% African American and 20% Hispanic.

4.4.3. TESTING OF SPECIFIC PROXY METHODS

To test the accuracy of BISG and other proxy methods, the CFPB utilized a database of consumer mortgage transactions reported under the Home Mortgage Disclosure Act (HMDA) for which race and ethnicity are self-reported. Utilizing the consumer's surname and addresses, the CFPB calculated BISG probabilities for each mortgage application and compared them to the self-reported race/ethnicity. The Rand authors used 2006 enrollment data from a large national health plan. Like HMDA, the health plan data included self-reported race/ethnicity as well as the address and surname information required to calculate BISG probabilities. They compare the estimated BISG probabilities to the self-reported race/ethnicity within the health plan data.

We adopt a similar approach to the CFPB and utilize a proprietary database of consumer mortgage transactions reported under HMDA. The CRA HMDA database contains approximately 292,000 mortgage applications and 190,000 originations. BISG probabilities are calculated for each application and compared to the self-reported race/ethnicity. The results discussed below are based on the applicant pool, which is more diverse with respect to FICO, income and other observable measures, relative to the origination pool. The accuracy metrics for BISG and the other proxy methods reported below deteriorate when calculated for the mortgage origination pool.

Table 8 reports the results at 50% and 80% threshold levels. False positives are situations where the proxy method suggests a consumer belongs to a group, when in fact they have asserted they do not. False negatives include consumers that self-report belonging to a particular group, but for whom the proxy method fails to categorize them at the given threshold. In essence, we are examining the accuracy of the proxy when the proxy suggests a relatively high probability of belonging to a specific group, and excluding those applications with relatively lower probabilities of belonging to any group.

November 19, 2014

American Financial Services Association

Table 8. Comparison of Proxy Approaches at Identifying Race/Ethnicity								
Proxy Method	Race/Ethnicity	Count of Borrowers in Group	Proxy = Yes Actual = Yes	Proxy = Yes Actual = No	Proxy = No Actual = Yes	Share of Actual Group		Percent Wrongly Included (false positives)
						Correctly Identified by Proxy	Not Identified by Proxy (false negatives)	
BISG-50%	African American	23,036	11,095	8,592	11,941	48.2%	51.8%	43.6%
	Hispanic	22,004	15,841	3,554	6,163	72.0%	28.0%	18.3%
	Asian	9,662	5,761	1,513	3,901	59.6%	40.4%	20.8%
	Non-Hispanic White	234,746	219,447	21,109	15,299	93.5%	6.5%	8.8%
BISG-80%	African American	23,036	5,567	1,606	17,469	24.2%	75.8%	22.4%
	Hispanic	22,004	12,892	1,964	9,112	58.6%	41.4%	13.2%
	Asian	9,662	4,857	806	4,805	50.3%	49.7%	14.2%
	Non-Hispanic White	234,746	182,304	10,759	52,442	77.7%	22.3%	5.6%
Tract-50%	African American	23,036	5,743	4,516	17,293	24.9%	75.1%	44.0%
	Hispanic	22,004	4,829	4,327	17,175	21.9%	78.1%	47.3%
	Asian	9,662	348	363	9,314	3.6%	96.4%	51.1%
	Non-Hispanic White	234,746	215,411	35,848	19,335	91.8%	8.2%	14.3%
Tract-80%	African American	23,036	2,275	671	20,761	9.9%	90.1%	22.8%
	Hispanic	22,004	1,723	575	20,281	7.8%	92.2%	25.0%
	Asian	9,662	10	6	9,652	0.1%	99.9%	37.5%
	Non-Hispanic White	234,746	134,561	12,245	100,185	57.3%	42.7%	8.3%
Name-50%	African American	23,036	2,570	2,384	20,466	11.2%	88.8%	48.1%
	Hispanic	22,004	15,852	3,799	6,152	72.0%	28.0%	19.3%
	Asian	9,662	5,531	1,400	4,131	57.2%	42.8%	20.2%
	Non-Hispanic White	234,746	205,789	26,437	28,957	87.7%	12.3%	11.4%
Name-80%	African American	23,036	832	182	22,204	3.6%	96.4%	17.9%
	Hispanic	22,004	14,612	2,965	7,392	66.4%	33.6%	16.9%
	Asian	9,662	4,726	805	4,936	48.9%	51.1%	14.6%
	Non-Hispanic White	234,746	131,001	8,323	103,745	55.8%	44.2%	6.0%

Source: HMDA augmented with proprietary data

A number of important trends are observed. There are clear differences across race/ethnicity groups. Geography alone does a poor job of identifying minority groups. Even at a 50% threshold only 24.9%, 21.9% and 3.6% of African American, Hispanic and Asian applicants, respectively, are correctly identified. Obviously, these percentages are even smaller when the threshold is increased to 80%. Name alone improves the results with respect to Hispanic and Asian applicants, but significantly reduces the share of African American applicants correctly identified. Given these poor results, the interest in more sophisticated alternatives is understandable.

The BISG results, however, are mixed. At an 80% threshold, BISG correctly identifies 24.2%, 58.6% and 50.3% of African American, Hispanic and Asian applicants, respectively, however this implies false negative rates of 75.8%, 41.4% and 49.7%, respectively. At this threshold, BISG fails to identify 3 out of 4 African American applicants and 4 out of 10 Hispanic applicants. While these rates are improved by moving to a 50% threshold, it comes at the expense of large increases in the rate of false positives – 43.6%, 18.3% and 20.8%, respectively. More intuitively, 4 out of 10 applicants that a BISG 50% threshold proxy identifies as African American are, in fact, not African American.

While we find that BISG-based probabilities may be relatively less inaccurate than geography-only and name-only proxy methods, the methodology is characterized by objectively high error rates. The CFPB's results, as reported in their White Paper are directionally consistent with these results; however we identified larger error rates. For example, the CFPB reported BISG, at an 80% threshold, correctly identified 39% of the actual African American consumers, compared to the 24.2% we identify.¹⁰⁷ These differences highlight just how wide-ranging the error rates can be based on alternative populations.

While we lack information on how the CFPB chose its test population, it is significantly less diverse with respect to race and ethnicity than our test population. Hispanic and African American applicants represent just 5.8% and 6.2%, respectively, of the CFPB's test population. The corresponding percentages in our test population are 7.5% and 7.8%. This may contribute to the CFPB's relatively lower, albeit still high, error rates.

¹⁰⁷ "Using publically available information to proxy for unidentified race and ethnicity: A methodology and assessment," CFPB, Summer 2014, released on September 17, 2014.

The size of these errors, combined with their potential to impact the estimated disparities and the associated alleged consumer harm, warrant further testing not performed in the CFPB's White Paper. Principally,

- Are the applicants who are identified representative of those that the proxy method fails to identify?
- Does representativeness vary across race/ethnicity group?
- Are the observed error rates non-random?
- What implications do these biases and error rates have on the subsequent steps in the CFPB's analytical approach?

To investigate these questions, we examined the false positive and false negative rates by tract race/ethnicity concentration, FICO ranges, income ranges and low-and-moderate income (LMI) tract definitions.¹⁰⁸ The results are presented in Appendix G.

While the patterns vary, the errors are non-random with respect to the four attributes. False negative rates are highest in tracts with the lowest shares of the group in question. For example, in tracts that are less than 10% African American, BISG at an 80% probability threshold fails to identify 98.0% of the actual African American applicants in such tracts. The false negative rates decrease as the within-tract share increases.

More problematic are the correlations with FICO, income and LMI status. In the case of African American and Hispanic applicants, false positive and negative rates have a generally strong positive correlation with FICO, income and LMI status. As FICO, income, and relative income (LMI status) increase, the ability of the BISG approach to identify accurately African Americans and Hispanics is diminished, as indicated by increased false negative rates. BISG's predictions become increasingly less accurate in identifying African American and Hispanic as FICO scores and incomes rise. Hence the African American and Hispanic applications identified under a threshold based approach appear not to be representative of the respective populations.

Using the continuous probability methodology of BISG does not improve the situation. With this methodology, all of the applications are included, regardless of the probability of belonging to a group identified by proxy. The correlations with FICO, income and LMI status remain in a continuous application. Table 9 presents the results of an additional simple test. We computed the average of the BISG

¹⁰⁸ As defined by Census.

probabilities for each race/ethnicity group across all 292,000 applications and the actual average share of the application pool that belongs to each group. The BISG methodology estimates that 11% of the applicant pool is African American, while the actual share is only 7.8%. This is a 41% overestimation of the African American share of the pool. As this test is a zero-sum-game, BISG must underestimate the shares of other groups – in this case, that group is non-Hispanic whites.

Table 9. Accuracy of Estimate using a Continuous BISG Methodology					
Race/Ethnicity	Actual Count	Actual Percent	BISG Count	Average BISG Percent	BISG Error
African American	23,036	7.8%	32,415	11.0%	40.7%
Hispanic	22,004	7.5%	22,200	7.6%	0.9%
Asian	9,662	3.3%	10,028	3.4%	3.8%
Non-Hispanic White	234,746	80.0%	223,031	76.0%	-5.0%

Source: HMDA augmented with proprietary data

The CFPB's results, as reported in their White Paper, are consistent with our results, although they found a larger overestimation for Hispanic and Asian consumers, while we found larger overestimation for African American consumers.¹⁰⁹ While the differences measured in percentage shares between the proxy outcome and the actual outcome may appear relatively small, they can represent large differences in population counts. For example, we find that BISG probabilities estimate approximately 32,415 African American in the test population, compared to the actual count of 23,036 African Americans – an overestimation of 41%. The CFPB reported a 21% overestimation of African Americans in their test population as shown in Table 10 below, reproduced from the CFPB's White Paper.

¹⁰⁹ "Using publically available information to proxy for unidentified race and ethnicity: A methodology and assessment," CFPB, Summer 2014, released on September 17, 2014, at 14, 15, 19, 20, 34, 35 and 36. available at: <http://www.consumerfinance.gov/reports/using-publicly-available-information-to-proxy-for-unidentified-race-and-ethnicity/>, last accessed October 19, 2014.

**Table 10. CFPB: Classification Over Ranges of BISG Proxy
For Non-Hispanic Black**

Black BISG Proxy Probability Range	Total Applications (1)	Estimated Black (BISG) (2)	Reported Black (3)	Reported White (4)	Reported Other Minority (5)
0-10	160,733	1,859	1,466	139,684	19,583
10-20	9,742	1,387	941	8,403	398
20-30	4,916	1,207	906	3,814	196
30-40	3,101	1,072	726	2,242	133
40-50	2,229	997	738	1,408	83
50-60	1,680	922	736	877	67
60-70	1,417	920	765	596	56
70-80	1,407	1,057	963	391	53
80-90	1,517	1,293	1,222	241	54
90-100	3,693	3,548	3,408	200	85
Total	190,435	14,262	11,871	157,856	20,708

Source: CFPB "Using Publicly Available Information to Proxy for Unidentified Race and Ethnicity,"
September 2014

Hence, BISG applied in either a continuous or threshold method, fails to well identify African American, Hispanic and Asian consumers representative of the respective populations.

To test the impact of the non-random random errors and resulting non-representativeness of the BISG probabilities on the subsequent steps in the CFPB's analytic framework, we conducted a simple test. Using our HMDA test population, we regressed the annual percentage rate (APR) on race and ethnicity without any other controls¹¹⁰ (e.g. the same raw regression the CFPB uses in step 2 to measure disparities in dealer reserve).¹¹¹ We first used actual race and ethnicity as the explanatory variables, and we next used the BISG continuous method to proxy race and ethnicity in the same manner used by the CFPB. In both cases the exact same

¹¹⁰ We used HMDA originations, rather than applications, for this test.

¹¹¹ *Op. Cit.*, CFPB Supervisory Highlights, 2014 at 10.

set of loans are included in the test population. These results are reported in Table 11.

Table 11. Comparison of Estimated Raw APR Disparities using Actual vs Proxied Race / Ethnicity					
Minority Group	Method	# Minorities	# Non-Hispanic Whites	Coef. (bps)	P-Value
African American	Actual Race / Ethnicity	12,022	157,579	14.1	0.000
	BISG Proportional	19,072	148,247	26.4	0.000
Hispanic	Actual Race / Ethnicity	13,587	157,579	19.0	0.000
	BISG Proportional	13,991	148,247	29.7	0.000
Asian	Actual Race / Ethnicity	6,405	157,579	-5.2	0.000
	BISG Proportional	6,848	148,247	-7.3	0.000

Source: HMDA augmented with proprietary data

When we use actual race and ethnicity to measure the raw APR disparity, we find raw disparities of 14.1 and 19.0 bps for African American and Hispanic mortgage borrowers, respectively.¹¹² However, when we use BISG proxies for race and ethnicity, we measure raw disparities of 26.4 and 29.7 bps, respectively. As a result of using biased proxy probabilities, the observed disparities are inflated by 87% and 57% for African American and Hispanic, respectively. Using HMDA data, we find that the biases and error rates inherent in the proxies used in step 1 of the CFPB's analytical approach, may lead to significant overestimation of disparities in step 2.

The biases measured using HMDA data are complex, but reflect lower rates of home ownership among Hispanic, African American, and Asian households relative to white non-Hispanic households. As discussed above, vehicle ownership also varies by race and ethnicity, with minorities significantly less likely to purchase, finance and own vehicles relative to non-minorities.

These biases and errors observed in step 1 and 2 of the CFPB's analytical framework have significant implications on the subsequent steps. They result in an overestimation of the CFPB's quantification of consumer harm (e.g. step 3). The CFPB calculates two types of consumer harm - direct and indirect.¹¹³ To quantify

¹¹² We would expect an APR model with no controls to measure some level of disadvantageous disparity with respect to race/ethnicity due to differing distributions of credit scores.

¹¹³ *Op. Cit.*, CFPB Supervisory Highlights, 2014 at 4.

direct harm, the CFPB applies the estimated disparities identified in step 2, measured in bps, to each contract in the portfolio and computes the dollar equivalent value, assuming that no contracts pay off before term.¹¹⁴ Thus every contract in the portfolio contributes some amount to the quantified harm, weighted by the relevant BISG probabilities and summed across the entire portfolio. Thus, if the number of minorities implied by the proxy method in step 1 is overstated (for example by the 41% we observed above) the quantification of harm will be overstated by a similar magnitude. Additionally, if the disparities estimated in step 2 are overstated (for example, by the 87% and 57% overstatements we observed above), the direct harm will be overstated by a similar magnitude – and completely incremental to the overstatement resulting from the proxy method implying more minorities than actually exist in the portfolio. The CFPB calculates indirect harm by assigning a fixed dollar amount (e.g. \$150) per allegedly harmed consumer. Hence, an overestimation of the number of allegedly harmed consumers by 41% results in an overestimation of indirect harm by approximately the same magnitude as both use 41% more protected class consumers.

The CFPB has not noted any corrections made for these overestimations, yet the Supervisory Highlights report that “Examination and enforcement teams have already reached resolutions with several supervised institutions that will collectively pay about \$136 million to provide redress for up to 425,000 consumers...”¹¹⁵ The Ally consent order is more explicit, reporting that approximately 100,000 African American consumers, 125,000 Hispanic consumers and 10,000 Asian consumers paid higher markups than the average of similarly situated non-Hispanic white markup.¹¹⁶

In the context of the automotive finance market, we calculated BISG probabilities for each of the 8.2 million consumers in the CRA Contract Data. A continuous-method application of BISG predicts 1,005,410 African American consumers. This BISG method cannot, however, identify which contracts the CFPB determine to be African American consumers. In fact, even though nearly 6 million of the contracts in our database have BISG African American probabilities of less than 10%, BISG, as applied by the CFPB, would suggest that 92,636 of these low probability contracts are associated with African American consumers. Chart 6 shows the counts of BISG- implied African American consumers by probability deciles. BISG applied in

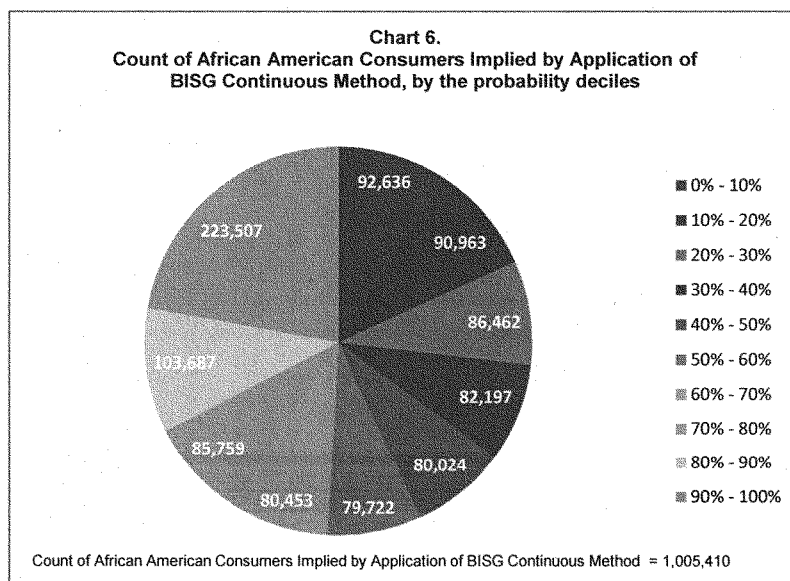
¹¹⁴ The CFPB has considered adjusting this for contracts paying off before term.

¹¹⁵ *Ibid.*

¹¹⁶ http://files.consumerfinance.gov/f/201312_cfpb_consent-order_0010.pdf

this manner is analogous to taking 6 million part-time workers and suggesting that they are equivalent to 92,000 full-time equivalents (FTEs).

One can observe these same phenomena in Tables 5 and 9-12 in the CFPB's White Paper. For example, in the CFPB's White Paper Table 10, reproduced above, the CFPB used a continuous BISG method to estimate 1,859 African American consumers exist in the group of 160,733 applicants. However, BISG provides no ability to identify which of the 160,733 are the theoretical 1,859 African American consumers. All 160,733 applications would be included in the CFPB's analysis and all would be given an African American weighting less than 10%, including the 1,466 consumers who are in fact African American. A similar pattern, less pronounced, is observed with respect to BISG-implied Hispanic and Asian consumers as reported by either the CFPB or in our results.



BISG applied in this manner provides essentially no useful information for the purpose of identifying and remunerating allegedly harmed consumers (e.g. step 4). Not only does this application dramatically overestimate the number of harmed consumers (and the alleged harm), but it also provides no ability to identify which contracts are associated with the allegedly harmed consumers. For example, as we

saw in Table 8 above, even among consumers with a greater than 80% probability of being African American, 22.4% of these consumers are in fact not African American. BISG has limited ability to differentiate the actual African Americans from the false positives implied by BISG.

To summarize, the methods commonly used by regulators to proxy race and ethnicity, including the recently applied BISG method, are conceptually flawed in their application. So while BISG may be relatively less inaccurate than proxies based on geography or surname alone, BISG remains subject to significant biases. The CFPB's use of biased race and ethnicity proxies creates significant measurement errors in the subsequent steps of its analytic framework, which likely result in dramatically overstated disparities, alleged harm and minority consumers.

4.5. MEASUREMENT OF DEALER RESERVE

Once the race/ethnicity determination is made, regulators may focus on various aspects of the consumer transaction. One generating much attention has been the measurement of disparities, if any, between the amounts of dealer reserve on minority compared to non-minority vehicle purchase contracts. The value of dealer reserves generally is measured either in bps, representing a share of the contract rate, or in dollars, or in dollars as a percent of the amount financed, etc. Additionally, it can be measured on either a gross or net basis, where gross is based on the term at origination and net is based on the actual term reflecting prepayment behavior. In our experience, the empirical results are sensitive to the units of measurement of dealer reserve. This sensitivity is consistent with economic theory as well as factors specific to automotive finance.

From the consumer's perspective, the contract rate, which includes any dealer reserve, measured in bps, is an important consideration, disclosed in the origination documentation. As well, a consumer's ultimate finance charges, also disclosed, are a function of the amount financed and term, not simply the contract rate. Everything else equal, 130 bps of dealer reserve on a \$17,974 contract is significantly less than the same reserve on a \$27,430 contract.¹¹⁷ Additionally, a consumer's sensitivity to the level of the contract rate and dealer reserve reflects numerous factors specific to the consumer including their expectations regarding prepayment and their ability to negotiate. While some vehicle contracts run full term, a large share of contracts may

¹¹⁷ These dollar amounts reflect the average amount financed on used and new vehicles, respectively, during Q4 2013. Source: Experian Automotive as published in the Automotive News F&I report, March 19, 2014.

pay off early. As a result, consumers pay, on average, the expected value of the total finance charge rather than the gross amount of finance charges.

Consistent with the actual consumer payment, the dealer receives the expected value of the dealer reserve, not the gross amount. This amount is paid to the dealer in dollars, not bps. This dynamic may be further complicated if a given financial institution allows each dealer from which it purchases contracts several alternatives for the calculation of the expected value of the dealer reserve. Hence, 130 bps of gross dealer reserve does not yield the same dollar-denominated payment to every dealer from whom the financial institution purchases such a contract, even if the amount financed and contract length are identical.

As the dealer considers its various revenues associated with a particular vehicle sale, it measures the value of the options in dollars. The implications of this are observable in the data. We observe negative correlations between the dealer reserve measured in bps and the amount financed. These patterns are generally observed within each race/ethnicity group. Additionally, the dealer may trade off the expected value of the dealer reserve with the available level of flat fees offered by various finance institutions if no dealer reserve is present (e.g. for those contracts for which the contract rate equals the buy rate). The flat fees have commonly ranged from \$0 to \$250 or \$300. More recently, some financial institutions have been experimenting with various forms of alternative flat compensation structures, such as 1% or 2% of the amount financed. Consequently, it is uncommon to see dealer reserves that equate to less than the available flat compensation amount.

Some of these patterns can be tested with the CRA Contract Data. In Appendix I we see dealer reserves in bps are larger on used transactions relative to new, but lower when measured in dollars.

4.6. COMPLEXITY OF THE TRANSACTION

The nature and structure of vehicle purchase transactions differs substantially from other forms of consumer finance. A thorough understanding of these differences is critical if one is to analyze and compare pricing outcomes accurately across various buyer segments.

The dealer and consumer face a complex set of contingent possibilities, costs, preferences and incentives as they attempt to reach mutually agreeable terms on a vehicle purchase. Attempts to evaluate dealer compensation, in isolation from these factors, may lead to erroneous conclusions. Some of these factors are common in data collected by financial institutions, including:

- Certain transaction specific attributes: new vs. used, age of a used vehicle, the presence and price of certain F&I products, presence and value of a trade-in, the make and model of the vehicle, the presence of a manufacturer-sponsored cash rebate used in the down payment, term of the contract, loan-to-value, debt-to-income, payment-to-income ratios, and the applicable cap on dealer reserve.
- Certain dealer-specific attributes: terms of the agreement between dealer and financial institution such as the dealer-reserve payment plan the dealer operates under, whether the dealer has a floor-plan arrangement or other borrowing relationships with the financial institution, and the State-level regulatory requirements applicable to the dealer.
- Certain consumer-specific attributes generally used in the underwriting process such as income, credit scores, time at residence, and the presence of an existing monthly auto payment.

The data demonstrate strong correlations between race/ethnicity and many of these factors. The CRA Contracts database demonstrates the following with respect to minorities:

- Disproportionate representation in the used vehicle segment.
- Longer original contract terms on average.
- Different choices with respect to the options afforded under manufacturer sponsored subvention programs.

The entire range of the contingent possibilities, costs, preferences and incentives are simply unknown to the financial institution, regulators and the fair lending analyst. In the next two sections we will discuss some of these unknown factors.

4.6.1. UNKNOWN CONSUMER-SPECIFIC FACTORS

As one attempts to analyze the pricing outcomes that resulted from the negotiation of a complex set of contingent possibilities, costs, preferences and incentives to reach mutually agreeable terms on a vehicle purchase, a significant information gap exists with respect to the vehicle purchaser's motivations. Unknown demand-side factors potentially impacting the consumer's negotiation of prices in the transaction include:

- Timing on the need to finalize the vehicle purchase.
- Ownership of another vehicle.
- Number of accessible dealers.
- Ability to shop across multiple dealers and direct lenders.
- Internet access.

- Amount of research engaged in prior to arriving at the dealer -- prices, rates, financial institutions and other relevant information.
- Flexibility with respect to make, model, color, and other options.
- Servicing at the dealer from whom they purchase the vehicle.
- Planned length of ownership.
- Intent to prepay contract.

The answers to these questions impact the prices the consumer will pay at the dealership. In the Pacifico and Springfield consent orders, the DOJ recognized that several factors, such as access to a more competitive rate, may have a direct impact on dealer reserves. Not only are these important factors, but they may vary by prohibited basis. Unlike a well-designed randomized controlled trial for which statistical sampling methods are used to increase the likelihood that such factors are randomly distributed across both the treatment and non-treatment groups and thus held constant, we have no such experiment that can be conducted with respect to vehicle purchases.

Limited academic research has been done on these questions with respect to race and ethnicity, but one finding of the studies is that women and minority vehicle buyers obtain greater benefit from internet access as compared to men and non-Hispanic white vehicle buyers.¹¹⁸ The results of research prior to the internet-age, which found that dealers quoted lower prices to white males relative to black and female test buyers using identical scripted bargaining strategies, is consistent with the value of such access to women and minorities.¹¹⁹ Certainly, the Census Bureau's statistics on internet access confirm a "digital divide" in which African American, Hispanic and age-65+ consumers are significantly less likely to use the internet, relative to non-Hispanic white and under 65 consumers.¹²⁰

The statistics cited in previous sections confirm that vehicle ownership patterns vary considerably by race/ethnicity -- resulting in certain minority groups being less likely to have an existing vehicle while searching for a replacement or additional vehicle. While there are clear differences among groups in the average contract length at

¹¹⁸ Florian Zettelmeyer, Fiona Scott Morton, Jorge Silva-Risso, "How the Internet Lowers Prices: Evidence from Matched Survey and Automobile Transaction Data," *Journal of Marketing Research*, Vol XLIII (May 2006), 168-181.

¹¹⁹ Fiona Scott Morton, Florian Zettelmeyer, Jorge Silva-Risso, "Consumer Information and Discrimination: Does the Internet Affect the Pricing of New Cars to Women and Minorities?," *Quantitative Marketing and Economics*, 1, 65-92, 2003.

¹²⁰ http://www.census.gov/hhes/computer/files/2012/Computer_Use_Infographic_FINAL.pdf

origination, it is difficult to infer whether this suggests different expectations regarding expected length of ownership or early payoff.

The observed differences among minority and non-minority buyers with respect to manufacturer-sponsored customer incentives offer some limited insights. Such manufacturer programs are commonly structured as a consumer choice between cash back at purchase (e.g. \$1,000) or a subvented contract rate (e.g. 0.9%). Our database suggests that minorities, relative to non-minorities, disproportionately choose the subvented contract rate. These programs nearly always prohibit the dealer from adding dealer reserve and require the contract to be assigned to the financial institution serving as the manufacturer captive. Such programs may represent a valuable option for consumers with greater sensitivity to the interest rate. Non-minorities disproportionately choose the cash back, suggesting potentially less sensitivity to the contract rate and a higher expectation of early payoff. These patterns should be viewed cautiously. Frequently such programs are offered on only selected vehicles and geographies, which may impact the observed patterns. Additionally, the patterns may change over time and across manufacturers. During the time periods analyzed in the private litigation on dealer reserve, it was not uncommon to observe minorities disproportionately choosing the cash rebate option. Given that the cash-rebate is commonly credited towards the down payment, this option can be helpful to consumers with relatively less savings upon which to draw.

Finally, we do not observe the dealer reserves on transactions that did not consummate in a sale. This could be the result of the buyer deciding to arrange their own financing or purchase from an alternative dealer, unwillingness of the consumer to accept the transaction terms presented by the dealer, or the inability of the dealer to identify a financial institution willing to purchase the contract. We do not observe transactions that were approved by the financial institution but assigned by the dealer to an alternative institution. Such observations would convey useful insights regarding the dealers and consumer's preferences, options and constraints.

In the automotive finance market we have unobservable customer-specific factors that have a causal impact on observed prices and correlation with prohibited basis.

4.6.2. UNKNOWN DEALER-SPECIFIC FACTORS

A similar information gap exists with respect to important dealer-specific factors. The dealer reserves charged by dealers cannot be fully understood without a thorough understanding of the dealer business model. The CFPB has consistently recognized that dealers deserve compensation for arranging consumers' financing. In its March 2013 Bulletin, the CFPB said "Dealer reserve is one method lenders use to compen-

sate dealers for the value they add by originating loans and finding financing sources.”¹²¹ How dealers operate, the interrelated nature of the products they offer, their cost structures, and the competitive environment impact the pricing policies and practices that govern what dealers charge for products and services. Unknown supply-side factors include:

- Dealer pricing policies and dealer reserve policies.
 - Example: has the dealer implemented NADA’s suggested Fair Lending program.¹²²
- Cost structure and expected departmental profitability targets.
- How often do they spot deliver the vehicle.
- Pull-through rate.¹²³
- Back-end coverage ratio.¹²⁴
- Number of relationships with indirect financial institutions.
- Assessment of the consumers’ potential to prepay early.
- Vehicle inventory levels.
- Inventory carrying costs.
- Presence of manufacturer-sponsored dealer incentives.
- Financial strength and stability.
- Ratio of new/used vehicle sales.
- Dependence upon repeat buyers.
- Proximity to other dealers.

While some of these factors can be held constant over all consumers at a given dealer, others cannot. For example, a dealer implementing NADA’s fair credit compliance program may deviate downward the dealer reserve it charges a given consumer based on a specific set of criteria – the same set of criteria established in the previously discussed DOJ consent orders with Pacifico and Springfield. While these criteria have a causal impact on observed dealer reserves, their presence is un-

¹²¹ CFPB Bulletin 2013-02 at 1.

¹²² NADA Fair Credit Compliance Policy & Program, 2014, currently available at http://www.nada.org/NR/rdonlyres/316F7BE3-499B-4A54-B56A-EFDF8414B04B/0/NADA_Fair_Credit_CompliancePolicy_Program.pdf.

¹²³ Pull-through rate is defined as the rate at which applications submitted by the dealer to various financial institutions are converted into actual contracts. Pull-through is distinct from the conversion rate, which is defined as the rate at which the dealer converts consumers “in the door” of the dealer into a vehicle purchase.

¹²⁴ Back-end coverage ratios measure the share of a dealers fixed costs that are covered by profitability from its service and parts departments.

known to the financial institution, regulators and the fair lending analyst, and this results in variation across transactions within the dealer. Several examples follow.

Early prepayment rates are significantly higher among super-prime (760+ FICO) consumers and dealers understand their historical early prepayment rates. During this period, the dealer has direct risk to the dealer reserve, as the entire amount is generally subject to rebate for the first 90-180 days in the event the contract does not perform or prepays during that period. Hence, dealers are less inclined to charge dealer reserves as their assessment of early prepayment risk increases. As we have seen previously, FICO is correlated with race/ethnicity and errors in BISG proxies.

As noted earlier, the financial institution does not know if the vehicle was spot delivered, with the contract rate established prior to the financial institution reviewing the credit application and underwriting the application. A strict reading of the CFPB's Supervisory Highlights might suggest that spot deliveries be excluded from monitoring analysis.

"The Supervisory focus on indirect auto lending, however, has been primarily concerned with the fair lending risk created by lenders' policies that compensate dealers by allowing them the discretion to mark up each consumer's interest rate *after* the lender has already underwritten the consumer's loan application and generated a risk-based price."¹²⁵

Vehicle inventory levels vary daily, weekly and seasonally based on a complex interplay of market demand and wholesale production and availability. The dealer may be considerably more willing to agree to lower transaction prices (including dealer reserve) on a vehicle that has been in inventory for some time as compared to a vehicle in higher-demand with more limited inventories. The DOJ has recognized that inventory considerations legitimately may have a direct impact on dealer reserves.

The presence of manufacturer-sponsored dealer incentives creates a similar supply-side dynamic. Dealer incentive payments averaged \$300 per vehicle in 2013 according to NADA and can be considerably larger. They are commonly structured by the manufacturer as a hurdle – sell the required number of vehicles in the allotted time period and collect the per vehicle payment on all vehicles, or miss the hurdle and collect no incentive payments. The expected value of the dealer incentive increases dramatically as the dealer approaches the sales threshold, and thus may be willing to accept considerably lower pricing on the last couple of vehicles prior to the

¹²⁵ *Op. Cit.*, CFPB Supervisory Highlights, 2014 at 5-6.

hurdle.¹²⁶ Because these are commonly model or even trim specific, they may have little impact on transactions for other models/trims within the same dealer. Finally, while it may be tempting to think of manufacturer-incentives (both dealer and cos-tumer) as relevant only to the market for new vehicles, that would be incorrect. Both incentives effectively reduce the price differential between new and used vehicles. When combined with the lower financing rates available on new vehicles, relative to used vehicles, the price differential is further reduced and potential used vehicle buyers may become new vehicle buyers.

In the automotive finance market, unobservable dealer-specific factors have a causal impact on observed prices and may be correlated with prohibited basis status, but this is not testable directly with available data.

The supply-side factors, such as cost structure, that are held constant across consumers at a given dealer, create a different challenge when attempting to understand observed difference across dealers at the portfolio-level. We examine these challenges in the next section.

4.7. PRICING DIFFERENCES ACROSS DEALERS

Pricing differences across dealers may create the appearance of disadvantageous pricing when aggregated to the financial institution's portfolio.

The CFPB has clearly mandated portfolio-level analysis. While the CFPB's March 2013 Bulletin says, "...indirect auto lenders that retain dealer markup and compensation policies *may wish* (emphasis added) to address the fair lending risks of such policies by....conducting regular analyses of both dealer-specific and portfolio-wide loan pricing for potential disparities on a prohibited basis resulting from dealer markup..."¹²⁷, their public statements have been more forceful. The CFPB/DOJ consent order with Ally requires both dealer-level and portfolio-level monitoring.¹²⁸

A fundamental challenge of portfolio-level analysis is the aggregation of contracts sourced from dealers with different operating models, cost structures, pricing policies, competitive landscapes and regulatory structures. These differences reflect the myriad of the dealer-specific attributes outlined in the previous section. As such,

¹²⁶ Meghan Busse, Florian Zettelmeyer, Jorge Silva-Risso, "\$1000 Cash Back: Asymmetric Information in Auto Manufacturer Promotions," NBER working paper series, Working Paper 10887 <http://www.nber.org/papers/w10887>

¹²⁷ CFPB Bulletin, 2013-02 at 4-5.

¹²⁸ http://files.consumerfinance.gov/f/201312_cfpb_consent-order_0010.pdf

even if each dealer sets prices in a manner that is neutral with respect to race and ethnicity, differences in the relative proportion of consumer market segments served by each group can result in the appearance of pricing disparities on a prohibited basis when the contracts from different dealers are aggregated to the financial institution's portfolio level.

Consider an example for which the financial institution's portfolio consists exclusively of contracts originated by two dealers. Both dealers have implemented the NADA Fair Credit Compliance Policy and Program and originate the identical number of contracts. The first dealer established its standard dealer reserve at 200 bps, while the second dealer established its standard dealer reserve at 150 bps. Neither dealer ever deviates downward from these standard amounts. Further, assume that the first dealer is in a higher-cost urban area and serves proportionately more African American consumers, while the second dealer is located in a lower-cost suburban area and serves proportionately fewer African American consumers. When portfolio level analysis is performed using the CFPB's methods, a statistically significant disadvantageous disparity will be observed, when in fact, there is no pricing disparity at either dealer individually and the dealer reserve differentials reflect the cost differentials faced by the dealers. The observed portfolio-level disparity is simply the result of aggregating across dealers with different pricing structures.

4.8. OBSERVABILITY OF DEALER CONTRACTS

Only a portion of dealer contracts are observable to a given financial institution. In this highly competitive market, dealers have relationships with numerous financial institutions. The aggregate numbers are illuminating: during 2013 there were approximately 34 million financed vehicle sales, originated at more than 55,000 dealers (franchised and independent), and financed by more than 65,000 financial institutions. We saw earlier how often dealers assign contracts to more than 50 different financial institutions. The economic, business and technology factors underpinning this phenomenon were explained earlier, but it has important implications on the analysis of observed pricing. The assignment of contracts is not random, and any given financial institution purchases a relatively small share of the contracts originated by each dealer. The financial institution cannot assess the application of dealer discretion with respect to dealer reserve and ECOA in a holistic manner.

Assessing the contracts the financial institution purchased from a given dealer is also challenging. Larger financial institutions purchase contracts from thousands of dealers, and it is not uncommon for medium-sized financial institutions to have relationships with well more than a thousand dealers. However, only a handful of dealers will be associated with more than a couple hundred contracts in the financial institu-

tion's portfolio. Given the issues with proxies, transaction complexity, and consumer- and deal-specific attributes, low contract volumes make the analysis of observed dealer reserves within a dealer subject to significant measurement error. In our experience dealer-level analysis, without sufficient volume thresholds, results in 'chasing randomness.'

In its September 2014 Supervisory Highlights, the CFPB acknowledged the challenge of measuring for disparate impact with low volume dealers, but stopped short of providing guidance as to specific contract volumes that it considers sufficient to enable meaningful dealer-level monitoring.¹²⁹ We note that the CFPB, in the same discussion, explicitly ruled out the exclusion of low volume dealers from portfolio-level monitoring. We hasten to point out the contradiction. If a dealer has too few contracts for meaningful comparison of prices charged to different groups, it is unclear why those contracts would be included in an aggregation exercise. Consider an example where no contracts from a dealer have an African American BISG probability greater than 80%, or even 50%. Including the contracts from this dealer does not add to the identification of potential disparities. Given the significant errors in proxy, combined with the complexity of these transaction and the unknown factors, the inclusion of such dealers in a portfolio-level analysis is specious.

5. OBSERVED PRICES IN THE CURRENT MARKET

In this section we analyze the prices observed in the automotive finance market during 2012 and 2013. We utilize the CRA Contract Data described in Section 4. The database includes both standard and subvented retail installment contracts and does not include vehicle leases. We estimate that it includes more than 30% and 10% of all financed new and used, respectively, vehicle purchases during the period. Descriptive statistics of the CRA Contract Data are provided in Appendix I, separately for new and used transactions, including and excluding subvented contracts. Consistent with the discussion above regarding the complexity, competitiveness and interconnectedness of the automotive retail and finance markets, we will analyze both transaction prices and financing prices.

We have previously studied transaction prices in the retail automotive market over a ten year period, utilizing financial data from five large, publically traded dealership groups.¹³⁰ This research found that franchised dealers priced the sale and financing of new and used vehicles, on average, at levels that are not sufficient to cover their

¹²⁹*Op. Cit.*, CFPB Supervisory Highlights, 2014, at 20.

¹³⁰*Op. Cit.*, Baines and Courchane, 2013.

costs, much less generate a profit and pay a return on invested capital.¹³¹ During the period analyzed (2002–2011), all, or nearly all, dealer net profits came from the servicing of vehicles after the sale. From the customer's perspective, the cost of purchasing and financing a vehicle is apparently being subsidized by future repair and maintenance costs (even though using the dealer for both functions is not required) in an interesting twist on the old expression "buy now, pay later."

These analyses established that dealers are, on average, pricing vehicles at a level that does not generate net profits, even after one includes the significant incentives paid to franchised dealers by the manufacturers. While the F&I department (including dealer reserve) generates a positive net profit, it is not large enough to offset the net losses generated by the pricing of new and used vehicles. Of course the facts and circumstances of each individual transaction, as well as the dealers' overall volume of sales, will impact the profitability of the various departments involved in the transaction. Nonetheless, the sale and financing of new and used vehicles reflect the dealers' inability, on average, to extract excessive profits.

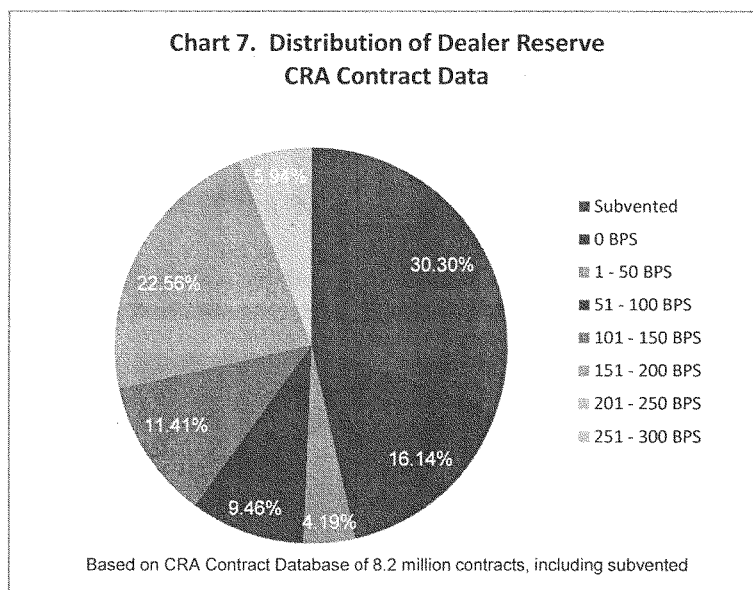
As we indicated at the time, we observed only average prices, not the range of prices paid by consumers. Therefore, we could not examine transaction prices with respect to a prohibited basis. Nonetheless, these findings are consistent with the observed market practice that dealers and consumers are purchasing and pricing multiple products and services in one transaction. These pricing dynamics provide a useful frame of reference as we attempt to evaluate the price of financing and draw accurate conclusions.

5.1. OBSERVED CONTRACT RATES AND BUY RATES

We observe average dealer reserves of 66 bps and 117 bps on new and used vehicle transactions, respectively, when subvented contracts are included.¹³² Chart 7 reports the distribution of observed dealer reserves across the entire CRA Contract Data.

¹³¹ We analyzed net profit, rather than gross profit which fails to consider the majority of dealer costs.

¹³² With only minor exceptions, dealers are not granted discretion to charge a dealer reserve on a subvented contract. Commonly, the dealer is paid a flat dollar amount as part of the manufacturer-sponsored incentive program.



Consistent with the earlier discussion regarding common caps on dealer reserve, 99% of transactions had dealer reserves equal to or less than 250 bps. Approximately 46% of all transactions had no dealer reserve (e.g. 'par' contracts). When subvented contracts are excluded, the observed dealer reserve are 110 bps and 132 bps on new and used, respectively, vehicle transactions, and approximately 23% of the transactions have no dealer reserve (see Appendix I). From this point on, we have excluded the subvented contracts from the analysis/discussion, as the dealer generally does not have discretion to charge a dealer reserve on such contracts.

These averages (excluding subvented contract) equate to about \$14 and \$12 on the average monthly payments for new and used transactions, respectively. These amounts are consistent with the data reported by the publically-traded auto groups.

These rates, however, are significantly lower than those reported by selected consumer advocacy groups.¹³³

To understand how dealers establish financing rates, we first analyzed the relationship between buy rates, contract rates and the implied dealer reserve. Consistent with standard risk-based pricing, buy rates are commonly a direct function of a number of factors, and while they may vary from one financial institution to the next, they almost always include the following:

- FICO/Custom Scores – higher scores, lower rates.
- New transactions have lower rates relative to used transactions.
- Older used vehicles have higher rates relative to newer used vehicles.
- Longer terms have higher rates relative to shorter terms.

As one would expect, we found buy rates and contract rates followed these patterns in aggregate regardless of race/ethnicity. Some commentators have noted that dealer reserves, expressed in bps, increase as creditworthiness declines, and we observe this pattern in the CRA Contract Data. These patterns are readily observable in the descriptive statistics reported in Appendix I.

These general trends obscure some interesting relationships among buy rate, contract rate and dealer reserve. When we hold constant risk, as measured by FICO, new/used and term, we observe wide ranges of buy rates (and contract rates) within every risk bucket.¹³⁴ Further the amount of dealer reserve appears not be random within each bucket. Within most non-prime and subprime risk buckets, dealer reserves decline as the buy rates increase. Consumers with the highest dealer reserves are observed to have among the lowest buy rates and contract rates. It is consistent with the dealer's ability and incentive to search multiple financial institutions for the lowest buy rate available on any given contract. In these credit tranches, dealers are increasing their dealer reserves by sourcing lower buy rates. Notwithstanding the higher dealer reserve, the consumers associated with these contracts are benefiting in the form of lower contract rates relative to other consumers of similar credit who faced higher buy rates and smaller dealer reserves. If BISG probabilities are to be believed, African American and Hispanic consumers disproportionately occupy these credit tranches. From the financial institutions perspective, this observation presents a dilemma. It suggests that financial institutions that offer the

¹³³ See, for example, Delvin David and Joshua M. Frank, "Under the Hood: Auto Loan Interest Rate Hikes Inflate Consumer Costs and Loan Losses," Center For Responsible Lending, April 19, 2011.

¹³⁴ We did not separate used vehicles by age of the vehicle.

most competitive (lowest) buy rates within the non-prime and subprime credit segments, may observe larger dealer reserves relative to financial institutions with less competitive rates.

The pattern in the prime segments is somewhat different. While we still observe a relatively wide range of buy rates and contract rates within each bucket, the lowest buy rates in a bucket are associated with relatively lower dealer reserves. In these categories, it appears that some consumers are able to extract nearly all of the value associated with lower buy rates. The dealer uses a network of competitive financial institutions to obtain a low buy rate, which is passed on to the consumer without a dealer reserve (however, the dealer generally gets paid a flat amount on such contracts). BISG probabilities suggest that non-Hispanic white consumers disproportionately occupy this credit tranche. In this credit tranche financial institutions with the most competitive rates would expect to see the lowest dealer reserves.

The divergent dealer reserve patterns across credit segments, combined with the relative shares with which each race/ethnicity group populate these segments, will lead to the potentially errant observation of pricing disparities if one uses the analytic framework utilized by the CFPB. Ironically, financial institutions with the most competitive buy rates may observe larger disparities relative to financial institutions with higher buy rates. This is one more indication that focusing exclusively on a single element of a pricing transaction can result in flawed findings.

The vigorous competition among financial institutions that is observed today results from financial institutions competing to offer dealers lower buy rates. The effect of caps currently set by many financial institutions is to pass some of the benefit of the lower buy rate on to the consumer. Dealers have strong incentives to collect their dealer reserve on the lowest buy rate they can obtain from their network of financial institutions. While the degree to which consumers benefit may vary across credit tranche, significant benefits to consumers were identified in all credit tranches

5.2. SIMILARLY SITUATED CONSUMERS AND CONTROLS

With no controls for the complexities and challenges discussed above, we measure raw, or uncontrolled, disparities of 16.9, 9.4, and 13.4 bps for BISG-predicted African American, Hispanic and Asian consumers, respectively.¹³⁵ All regression results are reported in Appendix J. These results are generated using the same method that the

¹³⁵ Results are based on an OLS regression technique, regressing dealer reserve (bps) on continuous BISG probabilities for race and ethnicity with no other explanatory variables.

CFPB uses in their analytic framework and the basis upon which it believes there is a fair lending risk associated with dealer reserve. We note that the adjusted R-squared on this raw regression is less than 1%, suggesting that the proxied race probabilities explain less than 1% of the variation in dealer reserves. In other circumstances, such as a well-designed randomized controlled trial, the low adjusted R-squared may be less of a concern. However, in this context, we believe it is a cause for concern.

These raw disparities ignore numerous factors, discussed above, that directly impact the dealer reserves charged by dealers. For example, this analysis ignores all seven factors identified by the DOJ as having a legitimate, causal impact on dealer reserve.¹³⁶ Thus, these results are not based on a comparison of similarly situated consumers, which is a fundamental premise and requirement of fair lending testing. These disparities also ignore the substantial problems identified in traditional and BISG proxy methods. In the following sections we will make adjustments, to the extent possible, for these issues.

5.2.1. ADJUSTING FOR PROXY BIAS

While the BISG probabilities cannot be corrected with respect to accuracy, one can mitigate the observed biases related to FICO, geography, income and LMI status. This may be accomplished to a limited extent by controlling for these factors directly in the model. We have tested a number of different specifications from these controls.

FICO

We have tested two specifications. The first segments FICO by major credit tranches: Super prime (760+), prime (720-759), non-prime (620-719) and subprime (<620). This specification has a number of advantages. In addition to partially controlling proxy bias, it reflects important market structures. As discussed above, dealers' options for arranging financing vary across these credit tranches. Consumers' finance options also vary significantly across these tranches, with those in lower credit tranches more reliant on dealer provided financing. Additionally, several of the unobservable attributes of consumers, such as 'the existence of a

¹³⁶ See Pacifico and Springfield settlements

competitive offer” are correlated with credit scores.¹³⁷ As such, credit tranche categories can serve as a proxy for these attributes.

Estimating the raw model with the inclusion of this credit tranche specification reduces the observed disparities, measured in bps, by 68% and 82% to 5.4 and 1.8 for contracts proxied to be African American and Hispanic, while the proxied Asian disparity slightly increased to 14.0 bps.

Second, we tested more refined FICO bands, segmenting FICO by 20 point categories, for example from 900-880, 879-860, 859-840, etc. This specification more closely models the observed bias in the proxy error.

Estimating the raw model and substituting this FICO specification for the credit tranches generates similar results. Observe disparities, measured in bps, of 4.5, 1.4 and 14.5 for contracts proxied to be African American, Hispanic and Asian, respectively.

Geography

We have tested two specifications of geography. The first is a simple state control. In addition to partially controlling proxy bias, it reflects important regulatory structures as states have different regulations with respect to consumer finance rates, indirect automotive finance and consumer protection. Estimating the raw model and including state controls, the observed disparities are 20.9, 12.6 and 15.2 bps for contracts proxied as African American, Hispanic and Asian, respectively.

Second, we refined the geography to control for MSA/MD (MSA) while maintaining the state control for contracts not in an MSA (e.g. more rural).¹³⁸ In addition to the advantages of a state control, this specification reflects important market structures - for example, the varying cost structures across dealers, discussed above. One of the drivers of those differences is location. Dealers located in Tysons Corner VA, (Washington-Arlington-Alexandria MSA 47894) likely face higher costs than dealers located in Southwestern VA. A similar control was commonly used by regulators in the fair lending analysis of wholesale mortgage broker fees, including yield spread premiums.

¹³⁷ One of the seven factors identified by the DOJ in the Springfield and Pacifico settlements as causing differences in observed dealer reserves.

¹³⁸ MSA refers to Metropolitan Statistical Areas. MD is a Metropolitan Division. These represent Census geographical designations.

Estimating the raw model and substituting the MSA specification for the former, we observe disparities of 19.8, 13.1 and 9.9 for contracts proxied to be African American, Hispanic and Asian, respectively.

Income

Given the longstanding concerns in fair lending analysis of controlling for absolute income, rather than relative measures such as payment-to-income ratios, we have tested a relative income specification based on the LMI splits used in the analysis of BISG proxies. We have created four indicators based on the LMI status of the tract in which the consumer resides - <50%, 50-80%, 80-120% and 120%+.

Estimating the raw model and including LMI splits, the observed disparities decrease by 24%, 25% and 3% for contracts proxied to be African American, Hispanic and Asian, respectively.

Finally, we tested a model combining credit tranches and MSA controls. With a more conservative approach, we choose to leave the LMI splits out of this model. We found the observed disparities declined by 54%, 41% and 25% to 7.8, 5.6 and 10.1 bps for contracts proxied to be African American, Hispanic, and Asian, respectively. We refer to this as the 'base model.' The adjusted-R-squared increased from 1% on the raw model to 5% with these two controls. We performed additional testing on the base model that strongly suggests these patterns hold within each race and ethnicity group. Using a threshold method to identify likely members of each race and ethnicity group, we ran the base model on each group individually and the results are reported in Appendix J. The coefficients are directionally consistent across each regression.

5.2.2. DEAL SPECIFIC CONTROLS

With the base model making important, but admittedly partial, adjustment for some of the challenges associated with proxying race and ethnicity, we can consider how to address some of the deal-specific challenges raised in Section 4.

It is relatively easy to control for dealer reserve caps that differ by term and new vs. used transactions. As noted above, it is common for financial institutions to have a 250 bps cap on contract lengths up to 60 months, and 200 bps on longer terms. Additionally, while average contract lengths have gotten longer over recent years, we observe in the CRA Contract Data certain minority groups, as identified by BISG, disproportionately have terms longer than 60 months, relative to non-minorities. Selected minority groups, as identified by BISG, are also more likely to purchase

used vehicles (where average dealer reserves are relatively higher) vs. new vehicles (where average dealer reserves are relatively lower).

Estimating the base model with the addition of a control for new/used and an indicator for contract length greater than 60, observed disparities on all three proxied minority groups are below 10 bps. We performed the same additional tests on the full model and found the coefficients across BISG-predicted race/ethnicity groups to be directionally consistent across each regression.

In summary, after adjusting, in part, for the biases inherent in race and ethnicity proxies, and controlling for basic and observable objective factors that impact dealer reserve, we observe potential disparities for African American, Hispanic and Asian consumers, identified by proxy, in the range of 6 - 9 bps. Given the average amounts financed and contract terms in our data, this equates to less than \$1 of monthly payment, or approximately 0.2% of the average monthly payment amount. Furthermore, this analysis does not consider the many unobservable factors that have a causal impact on dealer reserve, including those recognized by the DOJ, which include, among others whether or not the consumer had a competing offer of financing from another dealer or finance company, and whether or not the dealer has implemented a dealer reserve policy similar to the NADA Fair Credit Compliance Policy and Program.

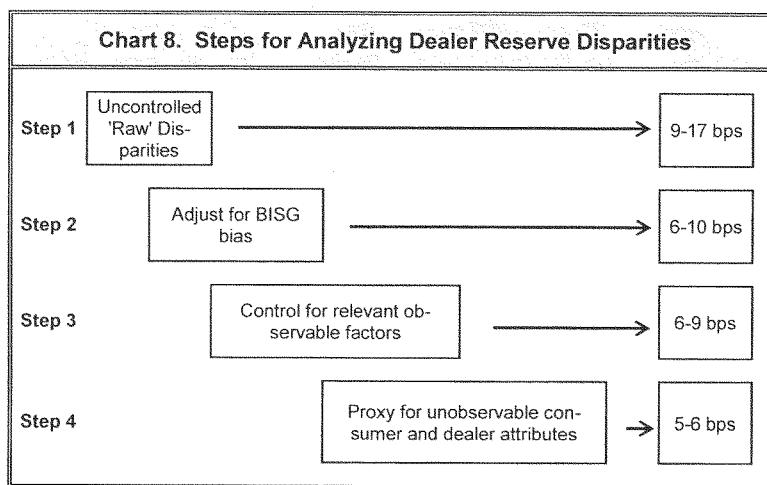
5.2.3. UNKNOWN FACTORS

As discussed above, these unknown dealer-specific, consumer-specific and deal-specific attributes impact the dealer reserves. For example, the seven factors articulated by the DOJ in the Springfield and Pacifico consent orders, are not available to the financial institution and we could not directly test their impact on observed dealer reserve disparities (see section 5 for a more complete discussion of unknown attributes).

While we cannot observe these factors and control for them directly, we can proxy for them. When a contract is observed to have zero dealer reserve, it may reflect the downward adjustments contemplated by the DOJ in Pacifico and Springfield, and it is economically reasonable to assume that one or more of the seven factors in those consent orders was potentially present. As we reported earlier approximately 23% of the non-subservent contracts have no dealer reserve. There are econometric issues with including zero dealer reserve contracts in the estimation, so we exclude them. This econometric limitation does not negate the economic and market significance of par contracts, thus our approach here is to exclude them from the analysis. If we exclude from our analysis all contracts with zero dealer reserves the observed raw

disparities fall to 7.9, 6.3 and 11.6 bps for African American, Hispanic and Asian contracts identified by proxy, respectively. These results suggest that more than half (54%) of the observed raw disparity measured for proxied African Americans is driven by the frequency of par contracts, rather than the level of positive dealer reserve. With respect to proxied Hispanic and Asian contracts, the frequency of par contracts accounts for 33% and 14%, respectively, of the raw disparity. From this perspective, we see how the analysis of dealer reserve critically hinges on a full understanding of the circumstances surrounding par contracts.

Once we apply the same controls described above and re-run the regression excluding contracts with no dealer reserve, we identify disparities of 5.2, 6.4 and 5.5 bps, respectively. Disparities at this level are in the range of \$.50 - \$.60 per month and economically de minimis as a share of the average monthly payment.



6. ALTERNATIVE DEALER COMPENSATION MODELS

In this section we analyze certain alternative dealer compensation models advocated by the CFPB. We present a number of hypothetical scenarios and use the CRA Contract Data to estimate costs and benefits to consumers under these alternative scenarios.

6.1. CFPB AND DOJ PREFERENCES

The CFPB has made clear its strong preference for certain alternatives to the current dealer compensation model. These appear to include flat dollar fees, flat percent of amount financed and 'hybrids.'¹³⁹ The DOJ, in public presentations, has included an additional alternative as outlined above in the Pacifico and Springfield settlements.

6.2. TESTING

As a simplifying assumption, we hold dealer revenue constant. This is consistent with the observed market, where despite dealers' extensive networks of financial institutions, dealers appear to be losing money on the sale of new and used vehicles, even after profits from the F&I department are included in the analysis.¹⁴⁰ A scenario where dealers earn less money in aggregate on the financing of vehicle appears unlikely and perhaps unsustainable. This is also consistent with our objective to study the costs and benefits to consumers rather than dealers.

If a compensation structure required flats (fixed compensation per contract), financial institutions would likely directly set the contract rate they offer to dealers. These contract rates would have to be substantially higher than current buy rates in order to pay flats on every contract, because the current buy rates are not set at a level to pay flats on 100% of contracts. As we observed above, in the current market financial institutions pay flats on no more than 23% of contracts (e.g. those with no dealer reserve).

Given this dynamic, one can test for:

- Who receives the higher contract rates and how much higher would those rates would be.
- Who receives lower rates and how much lower would those rates would be.

To address these questions, we implement four scenarios and report the results in Appendix K. The starting point was to calculate the dollar value of all dealer reserves across the entire portfolio. In each scenario we systematically converted the aggregate dealer reserves into equal flat amounts per contract. Next, we converted the flat amount in bps and added it to the observed buy rate – essentially

¹³⁹ *Op. Cit.*, CFPB Supervisory Highlights, Summer 2014.

¹⁴⁰ *Op. Cit.*, Baines and Courchane, 2013.

increasing each buy rates by an amount sufficient to pay the required flat. In this way, we re-priced the contract rate on each contract in the portfolio. Here again, we excluded subvented contracts from consideration. Each scenario tested a different mechanism for determining which contracts to re-price and by how much, always with the constraint of holding total dealer compensation constant.

6.2.1. SCENARIO 1

In scenario 1, we determine total dealer compensation separately for the new and used vehicle segments within each financial institution. The rationale for this is simple and reflects existing market realities. Buy rates are uniformly higher for used vehicles, all else equal; and used vehicles are considerable less expensive on average. These factors are important in converting dealer compensation into a flat and then back into the number of bps sufficient to pay the flat. It is also important to make these calculations separately for each financial institution, as they have different costs of capital, cost structures, etc. which influence the buy rates they offer in the market.

Across the portfolio, we observed 55% of contract rates were lowered, while 45% were raised. The average decline was approximately 66 bps, while the average increase was 82 bps. The increase equates to additional \$581 on average over the term of the contract.

With respect to race and ethnicity, proxied minority contracts were lowered only slightly more frequently than non-minority contract. Conversely, 42%, 43% and 43% of proxied African American, Hispanic and Asian contracts, respectively, would face higher contract rates in this scenario.

6.2.2. SCENARIO 2

In scenario 2, we added a third factor to the re-pricing mechanism – credit tranche. We believe this to be a more realistic assumption, as buy rates vary dramatically over the credit range and scenario 1 failed to consider this reality. Thus, in this scenario we calculated total dealer compensation within each financial institution, separately by new and used and six credit tranches. We then re-priced the contracts within each of these buckets.

Despite the important addition of credit tranche, the results are largely similar. Fifty-six percent of contract rates were lowered, while 44% were raised. The dollars are similar to those observed in Scenario 1, as are the results with respect to race and ethnicity.

It is important to note that in scenarios 1 and 2, 100% of the par contracts are re-priced to higher contract rates. This strikes us as a highly unlikely outcome for a variety of reasons discussed earlier – principally flats are already paid on most of these contracts. Additionally, many of these are likely to have present one or more of the factors outlined by DOJ in Springfield/Pacifico. Finally, these are disproportionately consumers with prime credit ratings, highly attractive to financial institutions, and as such consumers with potentially numerous financing options outside of the indirect channel.

In scenarios 3 and 4, we add the following constraint - the contract rate remains unchanged on par contracts.

6.2.3. SCENARIO 3

Scenario 3 parallels scenario 1, but for the additional constraint on par contracts. The results are striking. Less than half of the contracts (48%) face lower contract rates, and the dollar value of the average lower rate is decreased by 39% (to \$291 from \$476).

As before, proxied minority contracts are lowered at slightly higher rates, but nearly the same shares (27%-30%) of minority and non-minority contracts are raised.

6.2.4. SCENARIO 4

Scenario 4 parallels scenario 2, but for the additional constraint on par contracts. The results are not meaningfully divergent from scenario 3.

Summary

In all scenarios we observed significant shares of proxied minority contracts were re-priced to higher contract rates – in the range of 60 – 84 bps. So while the dealer reserve in the alternative world would be 0, the contract rates would be significantly higher for these consumers. These price increases are many multiples larger than any observed potential dealer reserve disparity. Additionally, they are at a level that creates significant concern regarding access to credit. Price increases of this magnitude have the real potential to price some individuals out of the market. Furthermore, we have not attempted to model the incentive dealers would have to assign a given contract to the financial institution offering the highest flat rate. Hence, these scenarios may underestimate the share of consumers facing higher contract rates.

In all scenarios, we observed that the share of raised contracts is nearly always the highest in the 760+ credit score tier. While scenarios 3 and 4 mitigate this result, it is not eliminated. It warrants an important caveat. These are consumers with the highest credit worthiness, and thus the most financing alternatives. Such a pricing scheme has the potential to drive some portion of them out of the indirect channel entirely. That could potentially have ramifications on the participants in the indirect automotive finance market. Do certain financial institutions leave the market entirely or switch to the direct channel? Can dealers remain in the business of arranging financing under such a scenario? The market is complicated and competitive, and it would be speculative to attempt to answer these questions with the data available to us in this Study.

Finally, we have not attempted to model the impact of the incentive dealers would have to assign contracts to the financial institutions with larger flats. Higher flats necessitate a higher contract rate, all else equal. Hence, these scenarios may underestimate the share of consumers facing higher contract rates under a flat or hybrid compensation structure.

7. CONCLUSIONS AND RECOMMENDATIONS

Given the dramatically increased regulatory activity concerning dealer reserve, we have examined indirect automobile finance practices, focusing on fair lending supervision. There is no question that the indirect auto market is highly competitive and complex. Failure to consider either competition or pricing complexities allows for the application of an overly-simplistic and biased analytical framework, which leads regulators to pursue overly onerous civil-money penalties from financial institutions.

Given the asymmetric nature of information between dealers and financial institutions, financial institutions and their regulators are in a less than ideal position to evaluate the pricing dynamics of transactions at dealers. Despite those limitations, our analysis finds that these pricing dynamics are largely explained by several objective factors, rather than by race and ethnicity.

Given the realities of the regulatory landscape and the limited tools available for analysis, the ability to perform meaningful, accurate and actionable analyses of dealer reserves at the portfolio level is very circumscribed. To partially account for the market complexities and the bias inherent in the BISG methodology, we recommend the following:

- (1) In calculating any disparities at the portfolio level, make adjustments to the population to:
 - a. Exclude any volumes from dealers with zero dealer reserve.

- b. Exclude any volumes from dealers with no variance in reserve.
 - c. Exclude any dealers with counts insufficient to monitor dealer activity – specifically, exclude dealers with fewer than 2 contracts from a minority consumer and 2 contracts from non-Hispanic white consumers and a total of 5 contracts. (Similar restrictions should be applied when analyzing for age or gender).
- (2) Implement economic controls to adjust for general economic conditions beyond the control of the financial institution or dealer. Specifically, adjust for:
 - a. Location -- the analyses should include MSA level fixed effect controls to control for competitiveness in local markets. Market demand/supply conditions clearly vary by MSA.
 - b. New/Used -- these markets are completely different on many dimensions and the negotiation around trade in values may directly impact dealer reserves.
 - c. Broad credit tranche -- this is not equivalent to controlling for credit score in the buy rate analysis but rather recognizes that prime and subprime markets vary broadly.
 - d. Month of origination.
- (3) Adjust for the known bias in the use of the BISG proxy methodology
 - a. If using a continuous approach, determine the "count" of affected minority consumers by applying a threshold after the application of the continuous method. That is, at the very least, the consumers with BISG probabilities less than 50% should not be included in any calculation of consumer harm.
 - b. Require verification/certification that any consumer receiving settlement funds or other remediated responses actually is a member of a protected class.
 - c. If funds remain in the settlement fund, these should revert to the financial institution and not become part of any regulatory "settlement fund."
- (4) When applying the BISG method, use a stricter threshold for any actions taken prior to 2012. The BISG approach had never been used historically, so one could have used it for monitoring, and applying a recent innovation to past behavior is unfair to financial institutions. For all originations prior to 2011, a 70% BISG threshold, or similar, should be applied.

- (5) Going forward, while financial institutions may, given sufficient volumes, monitor activity quarterly, no remediation should take place until the end of the year. This will help adjust for seasonality during an annual cycle.
- (6) The analysis should include a dealer level focus. There must be adjustments for the aggregation issue.
- (7) The continuous BISG methodology should not be used in any analysis of indirect auto underwriting. The econometric interpretation of such a result is overly difficult.

8. APPENDIX A. PROJECT TEAM

Charles River Associates is a leading global consulting firm that offers economic, financial, and business management expertise to major law firms, corporations, accounting firms, and governments around the world (see www.crai.com). CRA consultants have provided guidance in complex cases with a focus on analytics and its Financial Economics team, based in Washington, DC, and led by Dr. Marsha Courchane, undertook this research project. Our team combines a strong understanding of the retail automotive market, considerable experience conducting fair lending analyses in this and in other consumer finance markets, and specific experience with the methodologies used by various regulatory agencies, including the CFPB. In the course of our ongoing work and research, we regularly interact with financial institution regulators, leading academics, researchers at Census Bureau and elsewhere, and representatives from various banking and financial services associations, as well as others.

The project team was led by Arthur Baines and Marsha Courchane. Mr. Baines is a Vice President in the Financial Economics practice at CRA and has years of experience performing fair lending related analysis for bank and non-bank financial institutions in the indirect auto market and other consumer finance products; studying the retail automotive market in the United States; and developing econometric and financial models. Mr. Baines' early work in fair lending analysis was in connection with the regulatory investigations, conducted in the mid-1990s, of underwriting and pricing practices of non-bank auto finance companies. Subsequently, Mr. Baines analyzed the portfolios of numerous indirect auto financial institutions in the private litigations of the early 2000s alleging pricing discrimination related to dealer reserves. Currently, Mr. Baines and the CRA Financial Economics Practice are involved in numerous fair lending regulatory exams and investigations of finance institutions, including many brought by the CFPB and DOJ. Beyond the fair lending analysis, Mr. Baines has undertaken numerous projects related to the retail automotive market. He has studied the profitability of dealers, vehicle allocation and distribution systems, commercial financing of dealers and the complex relationship among dealers, manufacturer, customer and finance company (both captive and non-captive). Prior to joining CRA in 2010, Mr. Baines was a partner in the financial services practice at PwC and focused on automotive retail finance and vehicle distribution.

Dr. Courchane heads the Financial Economics Practice of Charles River Associates. She specializes in financial institution analyses for regulatory reviews and in support of litigation. Dr. Courchane is a leading expert in the areas of mortgage and consumer lending, including analyses of indirect vehicle finance for regulatory clients.

Her research and analyses with respect to mortgage markets, discrimination in lending, consumer credit, securitization, credit risk, and redlining issues has been widely cited and published in several journals, including the *Atlantic Economic Journal*, *Journal of Real Estate Research*, *Journal of Economics and Business*, *Housing Policy Debate*, *Applied Economics*, *Journal of Housing Economics*, *Journal of Housing Research*, *Journal of Real Estate Finance and Economics*, *Canadian Journal of Economics*, *Property Management*, *International Real Estate Review* and *Real Estate Economics*. She serves on the editorial board for the *Journal of Housing Research*, the *Journal of Real Estate Research*, and for the *International Journal of Housing Markets and Analysis* and referees for several journals. Dr. Courchane is a Fellow of the Weimer School of Advanced Studies in Real Estate and Land Economics. She is a member of Counselors in Real Estate (CRE). She is the Executive Vice President of the American Real Estate and Urban Economics Association (2008–2015) and served on the Board of Directors of the American Real Estate Society (2008–2014). Dr. Courchane also worked previously as a *Senior Financial Economist* in the Risk Analysis Division of the Office of the Comptroller of the Currency, Washington, DC. Her employment and her research have focused on fair lending analyses over the past twenty years.

9. **APPENDIX B. GLOSSARY OF TERMS AND ACRONYMS**

- ACS – American Community Survey
- AF-ABS – Auto finance asset backed securities
- AFSA – American Financial Services Association
- Ally - Ally Financial
- APR – Annual percentage rate
- Back-end ratio - Back-end coverage ratios measure the share of a dealer's fixed costs that are covered by profitability from its service and parts departments.
- Big 3 – Detroit-based manufacturers Chrysler, Ford, General Motors
- BISG – Bayesian Improved Surname Geocoding
- BLS – Bureau of Labor Statistics
- BPS – basis points
- Bulletin – CFPB Bulletin 2013-02, March 21, 2013.
- Buy Here Pay Here – a dealership that finances vehicle purchases and does not assign the resulting contract to a financial institution.
- Buy rate – the wholesale financing rates offered to the dealer by a financial institution in the indirect auto finance market.
- CEX - Consumer Expenditure Survey
- CFPB – Consumer Financial Protection Bureau
- CFPB White Paper - "Using publically available information to proxy for unidentified race and ethnicity, A methodology and assessment," CFPB, Summer 2014, released on September 17, 2014.
- Contract – Retail installment contract associated with the purchase of a new or used vehicle from a dealer
- Contract rate – The note rate negotiated between the dealer and consumer.
- The Court – The U.S. Supreme Court

- CPO – Certified Pre-Owned, a subset of the used vehicle market
 - CRA – Charles River Associates, Inc.
 - CRA Contract Data – A database consisting of approximately 8.2 million vehicle contracts originated during 2012 and 2013 via the indirect auto channel.
 - Customer incentives – Manufacturer-sponsored incentives offered to the consumer, generally cash rebates of subvented contract rates.
 - Dealer incentives – Manufacturer-sponsored incentives offered to the dealer for the sale of specific vehicles.
 - Dealer participation – The dollars paid to the dealer by the financial institution to acquire the contract. Participation includes dealer reserve and flats.
 - Dealer reserve – The amount by which the contract rate exceeds the buy rate.
 - Dealer reserve payment plan – The terms offered by the financial institution to the dealer governing the payment of dealer reserve to the dealers.
 - Dodd Frank Act - Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010
 - DOJ – Department of Justice
 - ECOA – Equal Credit Opportunity Act
 - F&I – Finance and Insurance
 - FDIC – Federal Deposit Insurance Corp
 - Flats – dealer compensation, generally in the form of a fixed dollar amount or fixed percentage of the amount financed.
 - FRB – Federal Reserve Board
 - FTC – Federal Trade Commission
 - FTE – Full-time equivalent
 - GAP - Guaranteed Auto Protection
 - GMAC – General Motors Acceptance Corp.
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- HHI - Herfindahl-Hirschman Index
 - HMDA – Home Mortgage Disclosure Act
 - Hybrids – a dealer compensation structure that combines flat dollar amounts and flat percentages of the amount financed.
 - Lift – the increase in race/ethnicity probabilities resulting from utilizing geography and surname probabilities in combination
 - LMI – Low Moderate Income
 - LMI Status – The relative ranking of a geography on the LMI scale
 - LTV – the loan-to-value ratio, in the indirect auto finance market it is commonly called the advance percent.
 - Make - The manufacturer of the vehicle. For example: Ford, Chevrolet, Toyota, BMW, etc.
 - Manufacturer-sponsored incentives – Financial incentives offered by the manufacturer on the sale of a specific vehicle(s).
 - MOU – memorandum of understanding
 - MSA – metropolitan statistical area
 - NADA – National Automobile Dealers Association
 - NIADA – National Independent Automobile Dealers Association
 - Note Rate – synonymous with the contract interest rate, excluding any one time fees.
 - OCC – Office of the Comptroller of the Currency
 - Pacifico - Pacifico Ford Inc.
 - Raw – Refers to the comparison of a given metric (e.g., denial rate) without controlling for any relevant factors.
 - Reg B - Federal Reserve Board's Regulation B, through which ECOA is implemented
 - RMBS – Residential mortgage backed securities
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- Similarly Situated – used in fair lending analyses, referring to a group of 2 or more applicants/buyers with similar relevant attributes.
- Springfield - Springfield Ford Inc.
- Vehicle model – Model differentiates vehicles of the same make. For example: Honda Accord, Ford Explorer, Chrysler 300.
- Vehicle trim – Trim differentiate vehicles of the same make and model. For example: Honda accord LE, Honda accord LX.
- YSP – Yield spread premium
- 18+ - Age designation, 18 years old and older.

10. APPENDIX C. HOUSEHOLD VEHICLE OWNERSHIP BY STATE AND RACE/ETHNICITY, 2010-2012

Year	State	# of Housing Units	% of Household with No Vehicle				% of Household with 1 Vehicle				% of Household with 2 Vehicles				% of Household with ≥2 Vehicles			
			Hispanic	Black	Asian	White	Hispanic	Black	Asian	White	Hispanic	Black	Asian	White	Hispanic	Black	Asian	White
2010	AL	19,649	5.7%	13.9%	6.7%	4.0%	31.3%	40.7%	30.0%	30.1%	36.8%	29.2%	42.9%	40.7%	24.2%	16.2%	20.5%	25.1%
2010	AK	2,447	3.9%	14.1%	6.4%	11.3%	28.8%	30.2%	34.2%	31.0%	41.8%	47.5%	43.0%	37.6%	43.0%	25.5%	8.1%	16.4%
2010	AZ	24,894	7.4%	14.9%	5.8%	6.2%	33.2%	41.4%	27.9%	39.9%	38.9%	31.1%	47.7%	38.6%	20.4%	12.6%	18.5%	15.3%
2010	AR	11,859	5.6%	16.4%	5.8%	5.1%	33.8%	42.7%	26.8%	32.0%	37.3%	26.5%	43.6%	41.3%	23.2%	14.4%	23.7%	21.6%
2010	CA	128,639	7.3%	14.5%	7.1%	6.9%	28.2%	39.4%	25.9%	35.2%	37.7%	30.2%	40.8%	37.7%	26.6%	15.9%	26.2%	20.2%
2010	CO	20,387	6.9%	13.7%	4.2%	5.1%	29.9%	41.9%	27.0%	31.9%	38.7%	29.7%	41.6%	40.6%	24.6%	14.7%	27.2%	22.4%
2010	CT	14,099	18.4%	20.6%	6.5%	5.7%	31.5%	39.3%	33.6%	32.0%	33.4%	27.4%	40.9%	40.2%	16.7%	12.7%	19.0%	21.1%
2010	DE	3,451	3.3%	15.3%	3.8%	5.1%	38.6%	40.5%	32.8%	33.2%	42.1%	30.3%	46.7%	41.7%	16.0%	13.9%	16.7%	20.0%
2010	DC	2,695	38.6%	38.8%	37.6%	26.3%	41.3%	41.6%	43.9%	51.4%	14.4%	14.7%	16.7%	18.2%	5.7%	5.0%	1.7%	4.0%
2010	FL	78,534	8.0%	12.4%	4.2%	5.5%	36.2%	44.3%	28.2%	43.0%	39.5%	30.7%	46.4%	36.6%	16.2%	12.6%	21.9%	13.0%
2010	GA	37,092	8.0%	12.6%	4.2%	3.5%	33.2%	42.5%	27.9%	30.0%	39.3%	29.9%	47.7%	43.2%	19.5%	15.0%	20.8%	23.4%
2010	HI	4,684	9.3%	6.2%	9.1%	9.0%	32.2%	42.3%	29.5%	39.2%	40.2%	34.6%	35.7%	36.5%	36.5%	16.9%	25.8%	15.4%
2010	ID	6,045	3.0%	14.4%	7.7%	4.4%	27.0%	28.3%	19.0%	27.1%	35.5%	35.3%	45.8%	39.1%	30.5%	22.0%	27.4%	29.3%
2010	IL	49,771	9.2%	23.6%	11.5%	7.6%	32.2%	44.4%	31.7%	34.1%	37.6%	22.3%	39.3%	39.6%	21.0%	9.7%	17.6%	18.7%
2010	IN	26,177	5.1%	14.3%	7.3%	5.4%	33.8%	46.3%	34.7%	31.7%	39.2%	27.1%	39.7%	40.2%	21.9%	12.3%	18.3%	22.8%
2010	IA	12,727	5.3%	17.2%	3.2%	5.5%	29.9%	43.4%	33.8%	29.2%	38.8%	28.8%	43.1%	40.2%	26.1%	10.6%	19.9%	25.1%
2010	KS	11,512	4.7%	12.7%	2.2%	4.8%	29.2%	38.1%	23.6%	30.0%	37.1%	32.5%	50.4%	40.0%	29.0%	16.8%	23.8%	25.2%
2010	KY	17,844	7.8%	17.5%	2.9%	6.7%	35.0%	41.7%	34.2%	32.5%	41.3%	27.5%	47.5%	39.3%	15.9%	13.2%	15.5%	21.5%
2010	LA	17,853	7.6%	17.1%	6.0%	4.9%	31.9%	42.7%	33.0%	35.1%	42.8%	27.0%	43.5%	41.8%	17.8%	13.1%	17.5%	16.3%
2010	ME	5,476	9.8%	17.2%	6.9%	5.6%	30.6%	37.0%	32.9%	33.8%	28.8%	26.5%	48.9%	41.1%	30.8%	19.3%	11.4%	18.6%
2010	MD	22,345	6.8%	17.7%	6.1%	5.8%	29.7%	38.8%	26.4%	30.1%	38.1%	29.2%	44.0%	40.5%	25.4%	14.7%	23.4%	23.6%
2010	MA	26,251	25.2%	25.7%	17.1%	10.2%	41.6%	43.5%	35.2%	34.7%	24.6%	22.5%	36.6%	39.2%	8.6%	8.3%	11.1%	15.9%
2010	MI	39,940	8.3%	18.1%	5.6%	5.7%	31.0%	46.7%	28.1%	33.6%	42.2%	25.3%	46.9%	40.9%	18.5%	9.9%	19.4%	19.7%
2010	MN	21,347	6.7%	22.5%	8.6%	5.8%	31.0%	40.6%	28.4%	30.0%	38.4%	27.1%	45.5%	40.9%	24.0%	9.8%	17.6%	23.2%
2010	MS	11,494	4.2%	13.6%	5.9%	3.8%	27.8%	39.5%	23.6%	30.5%	45.8%	29.3%	36.9%	40.8%	22.2%	17.6%	31.5%	24.8%
2010	MO	24,826	8.1%	19.6%	5.5%	5.8%	31.5%	45.4%	29.7%	32.1%	41.9%	25.2%	42.3%	40.4%	18.5%	9.8%	21.4%	21.8%
2010	MT	4,108	7.9%	0.6%	9.4%	5.0%	24.5%	32.3%	11.1%	27.5%	32.8%	43.1%	42.2%	39.0%	34.6%	24.0%	37.3%	28.4%

Year	State	# of Housing Units	% of Household with No Vehicle				% of Household with 1 Vehicle				% of Household with 2 Vehicles				% of Household with >2 Vehicles			
			Hispanic	Black	Asian	White	Hispanic	Black	Asian	White	Hispanic	Black	Asian	White	Hispanic	Black	Asian	White
2010	NE	7,421	8.1%	13.0%	5.7%	3.9%	21.2%	43.7%	30.3%	30.1%	45.9%	31.3%	42.8%	41.0%	25.2%	12.1%	21.1%	25.0%
2010	NH	10,568	7.3%	17.0%	4.6%	6.6%	31.4%	42.5%	31.2%	37.3%	41.5%	28.6%	43.0%	39.3%	19.8%	11.8%	21.3%	16.7%
2010	NH	5,216	11.2%	11.8%	2.3%	5.5%	29.7%	21.7%	24.3%	30.3%	35.1%	46.4%	52.0%	42.9%	21.0%	18.0%	21.3%	21.3%
2010	NJ	31,113	20.6%	22.6%	8.2%	7.3%	35.7%	40.6%	32.1%	33.4%	30.6%	26.2%	42.7%	40.0%	13.5%	10.6%	17.4%	19.3%
2010	NM	7,743	5.1%	9.9%	5.0%	5.1%	29.5%	37.5%	25.5%	37.4%	40.1%	34.8%	50.6%	38.3%	25.3%	17.8%	18.9%	19.2%
2010	NY	74,105	48.4%	47.9%	40.0%	18.7%	27.3%	32.8%	30.9%	33.8%	16.5%	14.0%	20.7%	33.1%	7.8%	5.3%	8.3%	14.4%
2010	NC	39,101	6.4%	13.6%	3.1%	4.4%	31.2%	40.0%	30.4%	31.0%	41.9%	29.8%	45.7%	40.9%	20.5%	16.7%	21.3%	23.7%
2010	ND	2,879	2.8%	5.8%	23.5%	5.6%	42.9%	53.5%	21.3%	28.9%	39.8%	34.5%	46.0%	37.8%	14.5%	6.2%	9.2%	27.7%
2010	OH	47,925	8.2%	19.7%	5.6%	6.4%	32.3%	45.0%	26.0%	31.7%	40.6%	25.9%	48.8%	40.5%	18.9%	9.3%	19.6%	21.4%
2010	OK	14,951	4.1%	13.4%	2.9%	4.7%	34.1%	40.4%	30.2%	32.4%	41.0%	29.3%	42.8%	41.0%	20.7%	16.8%	24.3%	21.9%
2010	OR	15,711	8.2%	15.6%	7.7%	7.8%	28.0%	35.9%	29.4%	32.4%	40.3%	34.4%	44.6%	38.1%	23.5%	14.2%	18.4%	21.7%
2010	PA	50,855	20.9%	33.7%	12.0%	8.2%	35.9%	39.2%	32.4%	32.4%	40.3%	34.4%	44.6%	38.1%	23.5%	14.2%	18.4%	21.7%
2010	RI	4,235	14.7%	21.7%	7.7%	8.7%	43.1%	44.1%	38.5%	35.4%	29.6%	28.3%	38.7%	37.1%	12.6%	6.6%	13.8%	19.2%
2010	SC	19,107	5.9%	15.4%	6.1%	4.1%	30.0%	39.1%	32.1%	31.5%	43.0%	27.9%	43.8%	42.5%	21.1%	17.5%	18.0%	21.8%
2010	SD	3,304	12.8%	10.8%	16.1%	5.8%	23.9%	30.0%	36.2%	28.1%	36.6%	47.6%	35.2%	35.7%	26.7%	11.6%	12.6%	30.3%
2010	TN	25,940	4.0%	14.2%	4.1%	4.7%	30.5%	43.7%	21.4%	30.9%	44.1%	28.3%	50.7%	40.6%	21.4%	14.3%	23.8%	23.8%
2010	TX	91,135	6.4%	12.2%	4.3%	4.2%	32.7%	42.7%	31.1%	34.3%	39.5%	31.3%	44.8%	42.8%	21.1%	13.8%	19.8%	18.7%
2010	UT	9,144	4.9%	8.0%	5.8%	4.3%	28.1%	32.6%	30.1%	25.8%	36.3%	34.5%	38.8%	41.9%	28.8%	24.9%	25.3%	27.9%
2010	VT	2,649	4.0%	15.2%	4.0%	6.9%	26.8%	23.9%	34.6%	34.2%	31.2%	37.6%	27.1%	38.4%	24.9%	25.3%	27.9%	27.9%
2010	VA	31,503	5.7%	12.0%	4.0%	4.3%	26.8%	37.5%	25.1%	29.5%	43.8%	30.8%	45.0%	39.7%	25.3%	19.6%	25.9%	26.1%
2010	WA	27,101	5.8%	11.1%	7.5%	6.4%	28.6%	38.6%	29.6%	31.6%	39.1%	35.3%	41.3%	38.1%	26.5%	16.8%	21.6%	24.0%
2010	WV	7,788	12.6%	17.4%	10.4%	8.0%	35.7%	48.2%	35.3%	39.0%	25.9%	41.6%	37.9%	41.6%	14.9%	8.5%	17.7%	19.4%
2010	WI	23,700	6.1%	20.8%	10.1%	6.1%	30.0%	44.1%	31.9%	31.7%	42.6%	25.8%	45.6%	41.7%	21.3%	9.3%	22.3%	20.6%
2010	WY	2,336	2.7%	10.7%	4.8%	3.6%	29.4%	31.6%	22.9%	25.8%	36.2%	39.2%	17.0%	38.0%	31.7%	18.6%	55.3%	32.6%
2010	National	1,403,777	11.2%	19.0%	9.9%	6.7%	31.2%	41.1%	28.7%	33.2%	36.8%	27.1%	40.3%	39.6%	20.8%	12.8%	21.1%	20.5%

Year	State	# of Housing Units	% of Household with No Vehicle				% of Household with 1 Vehicle				% of Household with 2 Vehicles				% of Household with >2 Vehicles			
			Hispanic	Black	Asian	White	Hispanic	Black	Asian	White	Hispanic	Black	Asian	White	Hispanic	Black	Asian	White
2011	AL	19,803	4.0%	13.6%	2.8%	4.0%	28.3%	41.3%	24.6%	39.7%	42.7%	27.8%	43.3%	41.3%	25.0%	17.3%	29.6%	25.1%
2011	AK	2,353	9.8%	15.8%	3.2%	10.7%	38.6%	34.0%	32.6%	30.6%	38.4%	35.6%	36.7%	41.2%	23.2%	14.7%	27.4%	17.1%
2011	AZ	24,862	8.3%	13.8%	6.7%	6.3%	33.9%	44.5%	29.8%	40.4%	37.7%	29.5%	44.7%	38.5%	20.1%	21.1%	18.8%	14.9%
2011	AR	11,927	5.2%	14.3%	5.2%	4.8%	35.9%	43.6%	28.2%	32.8%	39.4%	27.6%	47.8%	41.8%	19.5%	14.4%	18.8%	20.6%
2011	CA	120,032	8.0%	14.9%	7.5%	7.0%	28.9%	39.6%	26.4%	35.8%	37.3%	29.7%	40.7%	37.3%	25.8%	15.7%	25.4%	19.9%
2011	CO	20,507	6.4%	13.7%	6.1%	4.9%	31.3%	41.1%	28.1%	32.3%	38.7%	29.3%	39.3%	40.9%	23.7%	15.9%	26.5%	21.9%
2011	CT	14,066	18.7%	22.6%	8.8%	6.1%	40.1%	41.6%	31.0%	31.8%	27.7%	25.5%	43.9%	40.3%	13.5%	10.2%	18.2%	21.9%
2011	DE	3,552	2.3%	10.7%	6.6%	4.1%	29.8%	44.2%	30.0%	31.4%	44.3%	30.2%	47.8%	43.5%	23.5%	15.0%	15.5%	21.0%
2011	DC	2,800	44.1%	40.7%	43.5%	31.1%	37.0%	42.7%	42.0%	47.3%	16.8%	12.9%	10.3%	16.4%	7.2%	3.7%	3.9%	3.2%
2011	FL	78,931	8.8%	13.2%	4.3%	5.5%	35.6%	43.4%	27.4%	43.7%	40.1%	31.3%	48.7%	38.2%	15.6%	11.0%	19.4%	12.5%
2011	GA	36,816	5.9%	12.7%	4.7%	3.8%	34.6%	43.0%	28.2%	30.6%	39.3%	30.0%	45.4%	43.5%	19.2%	14.2%	20.7%	22.1%
2011	HI	4,698	7.9%	9.5%	8.7%	5.1%	31.5%	38.6%	30.2%	42.1%	35.5%	31.8%	37.7%	34.7%	24.2%	20.0%	23.4%	14.1%
2011	ID	6,001	4.9%	12.5%	4.9%	4.7%	25.1%	34.9%	30.7%	28.9%	40.1%	38.0%	38.9%	39.0%	29.8%	14.6%	25.4%	27.4%
2011	IL	49,620	9.9%	25.4%	10.8%	7.9%	31.7%	43.4%	32.4%	34.4%	38.5%	23.5%	40.6%	39.9%	20.0%	7.6%	16.3%	17.8%
2011	IN	26,004	5.6%	15.8%	7.5%	6.1%	33.6%	44.5%	35.5%	31.9%	42.4%	28.2%	38.0%	40.4%	11.5%	19.0%	21.6%	
2011	IA	12,731	7.7%	14.5%	10.7%	5.5%	35.9%	36.6%	35.9%	29.9%	32.7%	32.6%	30.2%	40.1%	23.7%	16.3%	23.2%	24.5%
2011	K5	11,497	5.8%	10.1%	7.7%	5.0%	29.5%	45.9%	25.4%	32.8%	43.6%	30.0%	46.9%	38.8%	21.2%	14.0%	20.0%	26.2%
2011	KY	17,772	10.9%	19.0%	8.9%	6.7%	32.5%	42.9%	32.5%	32.8%	39.3%	26.3%	37.9%	39.3%	17.3%	12.2%	20.8%	21.1%
2011	LA	17,877	8.1%	17.2%	8.3%	4.8%	32.1%	43.1%	28.2%	33.7%	38.1%	28.3%	40.3%	43.0%	16.7%	11.5%	23.1%	18.4%
2011	ME	5,997	15.9%	21.9%	4.9%	7.5%	29.5%	37.3%	29.0%	34.0%	30.4%	25.7%	40.8%	41.2%	24.2%	15.3%	25.4%	17.2%
2011	MD	22,423	9.1%	17.0%	6.5%	6.2%	29.9%	39.1%	26.5%	30.4%	38.3%	29.3%	43.7%	39.4%	22.7%	11.9%	23.3%	24.1%
2011	MA	26,356	24.8%	24.5%	14.4%	10.1%	40.2%	42.5%	35.6%	28.1%	24.3%	35.0%	38.7%	8.9%	8.7%	11.1%	15.6%	
2011	MI	39,709	5.3%	18.8%	5.9%	6.0%	34.3%	48.3%	33.5%	33.4%	42.8%	24.3%	40.4%	40.6%	17.7%	8.6%	20.3%	20.0%
2011	MN	21,451	12.6%	20.7%	7.5%	5.9%	34.0%	41.7%	31.7%	30.2%	34.6%	23.2%	41.3%	41.2%	18.8%	14.5%	19.0%	22.7%
2011	MS	11,476	3.8%	12.4%	6.7%	4.2%	34.4%	41.2%	28.3%	31.2%	36.5%	30.3%	45.3%	41.3%	25.3%	16.1%	19.8%	23.4%
2011	MO	24,772	6.3%	19.8%	7.5%	5.8%	29.8%	42.7%	33.2%	31.9%	42.4%	26.6%	41.9%	40.5%	21.5%	10.8%	17.4%	21.9%
2011	MT	4,128	0.9%	0.0%	0.9%	4.9%	28.4%	43.5%	24.6%	29.5%	41.2%	40.7%	43.2%	37.4%	29.5%	15.8%	31.4%	28.2%

Year	State	# of Housing Units	% of Household with No Vehicle				% of Household with 1 Vehicle				% of Household with 2 Vehicles				% of Household with >2 Vehicles			
			Hispanic	Black	Asian	White	Hispanic	Black	Asian	White	Hispanic	Black	Asian	White	Hispanic	Black	Asian	White
2011	NE	7,487	4.5%	18.2%	6.8%	5.4%	33.5%	35.0%	34.6%	38.5%	39.0%	37.6%	40.8%	40.8%	22.6%	15.7%	21.0%	24.8%
2011	NH	10,441	7.4%	17.3%	8.7%	7.0%	33.3%	44.0%	33.6%	38.3%	40.8%	25.7%	41.4%	37.4%	18.4%	11.0%	18.3%	17.3%
2011	NY	5,335	8.3%	13.5%	8.9%	4.8%	25.7%	35.8%	27.9%	31.2%	42.2%	31.6%	45.0%	43.3%	17.6%	19.2%	18.2%	20.6%
2011	NJ	33,077	21.5%	23.5%	8.1%	7.3%	35.7%	40.8%	31.6%	34.3%	29.3%	33.2%	43.7%	38.1%	13.5%	10.5%	16.6%	20.3%
2011	NM	7,708	6.1%	7.1%	8.2%	6.4%	29.6%	33.2%	28.8%	36.8%	37.2%	43.7%	37.7%	36.6%	27.1%	16.0%	25.7%	20.2%
2011	NV	74,129	47.9%	47.1%	38.4%	19.4%	28.4%	32.4%	33.2%	33.6%	16.1%	15.4%	20.6%	32.9%	7.7%	5.1%	7.7%	14.1%
2011	NC	38,903	6.4%	14.2%	3.7%	4.5%	33.3%	40.0%	27.0%	30.1%	40.1%	29.1%	47.8%	42.7%	20.3%	16.7%	21.5%	23.3%
2011	ND	2,885	4.2%	4.4%	23.0%	4.8%	21.3%	29.1%	35.1%	29.7%	55.1%	22.8%	17.1%	38.0%	19.4%	43.7%	24.8%	27.5%
2011	OH	47,813	8.4%	20.5%	4.8%	6.4%	37.1%	45.4%	29.5%	32.8%	38.3%	24.8%	46.4%	39.6%	16.2%	9.4%	19.4%	21.3%
2011	OK	14,775	5.1%	14.1%	5.2%	5.0%	32.1%	43.8%	28.4%	33.1%	43.8%	28.6%	47.7%	39.5%	19.0%	13.4%	18.7%	22.4%
2011	OR	15,782	7.4%	18.3%	6.0%	7.8%	30.0%	31.1%	30.4%	33.9%	40.5%	37.5%	44.7%	38.1%	22.1%	13.1%	18.9%	20.8%
2011	PA	51,002	19.9%	33.8%	15.2%	8.4%	35.2%	39.2%	31.4%	33.5%	30.8%	20.5%	38.8%	38.6%	14.0%	6.5%	14.6%	19.5%
2011	RI	4,299	19.2%	21.3%	9.3%	8.3%	38.1%	40.9%	34.2%	35.9%	34.7%	26.2%	40.7%	39.2%	8.0%	12.2%	17.2%	18.6%
2011	SC	19,134	6.1%	15.1%	3.5%	4.5%	33.7%	40.5%	30.6%	40.6%	41.0%	28.0%	54.1%	43.7%	19.2%	16.5%	18.4%	21.8%
2011	SD	3,318	2.0%	9.9%	0.0%	6.7%	41.5%	37.9%	43.0%	27.7%	30.4%	33.2%	34.5%	36.7%	26.1%	19.0%	23.5%	28.8%
2011	TN	26,007	5.2%	15.1%	5.0%	5.0%	29.4%	44.7%	25.5%	31.5%	47.9%	27.0%	43.7%	40.1%	22.5%	13.2%	25.8%	23.4%
2011	TX	91,625	6.6%	12.2%	4.2%	4.2%	32.3%	44.4%	28.7%	34.0%	40.6%	29.9%	46.2%	42.7%	20.2%	13.5%	20.8%	19.1%
2011	UT	9,135	5.4%	7.7%	5.6%	4.9%	28.7%	38.1%	23.3%	26.6%	41.6%	32.8%	43.3%	42.5%	24.3%	21.4%	27.6%	26.0%
2011	VT	2,670	5.5%	6.7%	6.2%	5.7%	31.6%	40.4%	25.3%	32.2%	38.6%	20.7%	37.0%	42.7%	24.3%	21.3%	31.0%	19.4%
2011	VA	31,525	5.7%	12.5%	3.9%	4.5%	26.3%	36.5%	27.3%	29.4%	40.9%	30.6%	45.0%	40.3%	26.7%	20.4%	23.8%	25.8%
2011	WA	27,196	5.6%	14.6%	6.9%	6.7%	28.0%	39.1%	29.4%	30.7%	35.0%	31.0%	41.7%	37.8%	27.4%	15.3%	21.5%	24.9%
2011	WV	7,754	9.7%	24.8%	9.9%	8.6%	29.8%	38.4%	36.0%	36.0%	35.1%	24.6%	28.2%	36.9%	25.3%	12.2%	25.8%	18.5%
2011	WI	23,662	8.7%	22.6%	9.5%	6.2%	32.7%	46.6%	29.3%	31.7%	41.1%	24.0%	44.5%	41.0%	17.5%	6.8%	16.7%	21.0%
2011	WY	2,358	3.7%	24.4%	9.0%	3.4%	27.1%	11.4%	45.6%	25.5%	41.9%	31.8%	22.0%	39.6%	27.3%	32.4%	23.4%	31.5%
2011	National	1,204,830	11.5%	19.2%	10.1%	6.9%	31.7%	41.4%	29.2%	33.4%	36.7%	26.9%	40.2%	39.5%	20.1%	12.4%	20.6%	20.2%

Year	State	# of Housing Units	% of Household with No Vehicle				% of Household with 1 Vehicle				% of Household with 2 Vehicles				% of Household with >2 Vehicles			
			Hispanic	Black	Asian	White	Hispanic	Black	Asian	White	Hispanic	Black	Asian	White	Hispanic	Black	Asian	White
2012	AL	19,697	2.8%	13.7%	3.8%	4.1%	28.0%	41.3%	38.0%	30.5%	47.0%	48.7%	39.3%	33.7%	72.2%	18.1%	19.5%	25.5%
2012	AK	2,293	7.5%	1.9%	7.4%	11.0%	38.7%	46.1%	29.8%	32.5%	45.6%	41.2%	37.7%	33.7%	18.1%	10.9%	25.4%	22.8%
2012	AZ	25,180	7.3%	13.7%	6.4%	6.3%	31.6%	43.7%	32.2%	41.2%	40.5%	30.7%	44.0%	37.6%	20.5%	11.9%	17.4%	14.9%
2012	AR	12,007	5.7%	16.1%	5.9%	4.9%	28.6%	45.7%	35.5%	32.8%	43.4%	26.6%	42.8%	40.9%	22.4%	11.6%	15.7%	21.3%
2012	CA	129,234	7.4%	14.9%	7.5%	6.9%	29.0%	40.1%	26.7%	35.6%	38.2%	29.6%	40.8%	37.8%	25.4%	15.4%	24.9%	19.6%
2012	CO	20,584	7.9%	10.9%	5.7%	4.8%	30.3%	39.0%	25.6%	32.4%	37.9%	33.5%	43.1%	40.6%	23.9%	16.6%	25.5%	22.3%
2012	CT	14,055	17.4%	20.4%	5.6%	6.0%	36.1%	40.5%	28.3%	31.3%	31.8%	27.5%	48.0%	40.7%	14.7%	11.5%	18.1%	22.0%
2012	DE	3,532	6.3%	12.1%	3.6%	4.0%	29.5%	36.9%	29.6%	33.6%	41.0%	31.7%	40.0%	43.3%	23.2%	19.3%	26.8%	19.2%
2012	DC	2,781	41.8%	41.4%	35.5%	31.7%	43.0%	40.7%	43.5%	49.0%	10.4%	13.1%	12.9%	16.7%	4.8%	4.8%	8.2%	2.5%
2012	FL	79,097	8.4%	13.7%	4.4%	5.8%	36.4%	44.7%	29.6%	43.6%	39.6%	29.8%	46.6%	38.0%	15.5%	11.7%	19.3%	13.2%
2012	GA	37,216	7.3%	13.0%	4.7%	3.7%	33.8%	42.6%	25.9%	30.7%	38.8%	29.6%	46.8%	42.1%	19.1%	14.8%	23.4%	22.4%
2012	HI	4,700	6.1%	8.9%	8.4%	5.5%	35.5%	42.6%	31.7%	41.9%	34.8%	37.7%	35.0%	35.3%	23.6%	10.8%	24.2%	13.4%
2012	ID	5,961	5.3%	1.3%	2.8%	4.9%	25.4%	40.0%	22.2%	28.5%	39.1%	29.5%	30.0%	39.8%	30.2%	29.2%	45.1%	26.8%
2012	IL	49,694	9.6%	25.9%	13.3%	7.7%	31.1%	43.5%	32.1%	34.2%	39.8%	21.6%	39.8%	39.3%	19.5%	9.0%	14.7%	18.7%
2012	IN	26,125	6.0%	16.6%	6.4%	5.8%	30.3%	44.6%	35.9%	31.7%	38.5%	28.0%	42.1%	40.1%	25.1%	10.8%	15.6%	22.4%
2012	IA	12,767	5.5%	13.9%	7.0%	5.2%	28.8%	41.8%	33.9%	38.9%	42.2%	29.2%	37.7%	41.1%	23.6%	15.1%	21.4%	24.9%
2012	KS	11,545	5.4%	12.6%	8.0%	5.1%	28.3%	42.5%	33.3%	30.1%	42.2%	29.6%	36.6%	39.4%	24.1%	15.2%	22.1%	25.3%
2012	KY	17,964	6.9%	17.8%	7.6%	6.8%	33.7%	44.8%	31.9%	31.9%	41.7%	25.0%	38.8%	39.6%	17.6%	11.8%	21.8%	21.8%
2012	LA	17,930	6.8%	15.7%	4.8%	5.1%	35.4%	44.6%	33.6%	34.4%	41.3%	22.0%	43.7%	42.0%	16.5%	12.6%	17.8%	18.4%
2012	ME	5,538	11.1%	21.0%	2.5%	6.5%	40.4%	45.9%	20.9%	35.2%	38.0%	72.4%	49.3%	39.2%	10.4%	10.7%	27.3%	19.1%
2012	MD	22,494	8.3%	17.1%	5.9%	5.8%	29.1%	40.0%	25.7%	30.6%	39.3%	28.1%	45.6%	39.7%	23.3%	14.8%	21.8%	23.8%
2012	MA	26,220	23.0%	24.5%	16.3%	9.7%	41.3%	43.0%	34.0%	35.1%	27.3%	23.9%	37.5%	39.1%	8.4%	8.6%	11.1%	15.1%
2012	MI	39,659	8.4%	20.7%	6.8%	5.8%	32.0%	44.3%	30.5%	33.1%	40.1%	26.0%	43.7%	40.5%	19.5%	9.0%	18.9%	20.5%
2012	MN	21,400	8.0%	22.1%	5.3%	6.0%	31.8%	40.2%	28.8%	29.1%	41.1%	28.4%	44.7%	41.4%	19.1%	9.4%	21.3%	23.5%
2012	MS	11,550	2.3%	12.2%	5.4%	3.6%	31.1%	42.6%	30.5%	30.6%	37.3%	29.1%	40.8%	41.8%	29.2%	16.1%	23.3%	23.9%
2012	MO	24,799	7.0%	19.8%	5.6%	5.9%	31.5%	46.2%	25.8%	31.9%	39.8%	24.3%	42.1%	40.3%	21.7%	9.8%	26.5%	21.9%
2012	MT	4,146	2.7%	10.0%	4.7%	6.0%	42.1%	57.3%	35.3%	28.4%	32.0%	20.9%	33.7%	36.7%	23.2%	11.6%	26.3%	28.8%

Year	State	# of Housing Units	% of Household with No Vehicle				% of Household with 1 Vehicle				% of Household with 2 Vehicles				% of Household with 3+ Vehicles			
			Hispanic	Black	Asian	White	Hispanic	Black	Asian	White	Hispanic	Black	Asian	White	Hispanic	Black	Asian	White
2012	NE	7,523	4.0%	12.7%	4.7%	4.8%	28.1%	45.6%	30.0%	29.2%	41.6%	31.2%	46.5%	46.6%	26.3%	10.5%	18.8%	25.3%
2012	NI	10,605	7.4%	19.0%	5.9%	7.2%	31.1%	41.0%	28.8%	38.7%	42.9%	27.4%	46.1%	36.9%	18.7%	12.7%	19.2%	17.2%
2012	NI	5,362	9.8%	12.7%	3.8%	5.5%	16.9%	31.1%	37.3%	31.1%	46.9%	46.1%	47.9%	42.7%	24.4%	9.9%	16.0%	20.7%
2012	NJ	33,037	21.1%	22.3%	7.7%	7.5%	34.3%	40.8%	31.3%	33.4%	31.6%	25.8%	42.4%	39.3%	13.0%	11.1%	18.6%	19.9%
2012	NM	7,720	5.5%	11.7%	2.7%	5.8%	31.2%	36.8%	27.5%	36.7%	38.0%	40.4%	43.4%	37.2%	25.3%	11.2%	26.3%	20.2%
2012	NV	74,151	49.0%	46.7%	40.6%	19.3%	28.8%	33.7%	31.8%	33.7%	14.8%	14.3%	20.2%	32.6%	7.4%	5.3%	7.4%	14.4%
2012	NC	39,120	7.0%	14.1%	3.8%	4.4%	30.9%	40.3%	29.9%	31.3%	40.1%	29.1%	44.6%	41.4%	22.1%	16.6%	21.6%	23.1%
2012	ND	2,949	1.3%	3.1%	31.5%	5.6%	21.2%	30.1%	33.7%	28.2%	58.5%	53.5%	18.1%	37.2%	19.0%	13.3%	14.7%	29.0%
2012	OH	47,763	10.3%	19.8%	7.6%	6.3%	34.5%	45.3%	32.7%	33.3%	38.5%	25.7%	42.3%	39.2%	16.6%	9.0%	17.8%	21.3%
2012	OK	14,455	3.9%	13.3%	5.9%	5.2%	30.4%	40.8%	25.3%	33.0%	43.3%	31.9%	43.1%	41.0%	22.5%	14.0%	25.7%	20.9%
2012	OR	15,884	7.9%	16.6%	8.9%	8.3%	27.7%	37.6%	29.6%	33.1%	42.0%	31.5%	42.8%	37.1%	22.3%	14.4%	18.7%	21.5%
2012	PA	50,980	20.4%	31.4%	12.6%	8.1%	36.7%	41.9%	34.1%	33.2%	21.7%	20.1%	38.3%	39.9%	11.3%	6.8%	15.0%	19.9%
2012	RI	4,281	17.1%	19.9%	8.9%	8.9%	46.9%	42.7%	37.9%	35.0%	26.7%	26.8%	37.2%	38.0%	9.8%	10.6%	16.0%	18.1%
2012	SC	19,128	6.2%	14.3%	2.7%	4.3%	29.4%	40.7%	25.0%	32.1%	46.8%	29.7%	45.7%	42.1%	17.5%	15.8%	26.7%	21.5%
2012	SD	3,333	2.4%	2.7%	6.6%	4.2%	27.4%	57.6%	20.7%	28.5%	48.6%	24.6%	52.2%	39.9%	21.7%	15.1%	20.5%	27.4%
2012	TN	26,107	3.2%	13.7%	5.3%	4.6%	27.9%	43.8%	28.8%	31.6%	44.2%	28.0%	43.6%	40.1%	24.6%	14.6%	22.2%	23.7%
2012	TX	92,834	6.1%	12.2%	4.3%	4.0%	32.1%	42.7%	29.1%	34.4%	40.0%	30.7%	46.9%	42.8%	21.9%	14.3%	19.7%	18.8%
2012	UT	9,167	4.5%	8.7%	6.2%	4.4%	27.3%	28.4%	31.8%	26.1%	36.4%	34.5%	37.3%	41.9%	31.6%	28.5%	24.7%	27.6%
2012	VT	2,669	14.9%	3.0%	7.5%	6.7%	35.4%	68.1%	39.0%	32.3%	38.4%	10.7%	36.4%	42.8%	11.3%	18.3%	17.0%	18.2%
2012	VA	31,905	5.5%	11.9%	4.0%	4.7%	26.1%	38.3%	23.7%	29.1%	42.8%	29.4%	45.3%	39.8%	25.6%	20.4%	27.0%	26.4%
2012	WA	27,591	4.9%	12.1%	6.9%	6.5%	29.5%	38.6%	30.0%	31.2%	39.4%	35.1%	40.2%	37.8%	26.3%	14.2%	21.9%	24.5%
2012	WV	7,727	15.7%	20.7%	3.3%	8.3%	28.9%	39.4%	22.8%	37.0%	45.0%	27.5%	41.5%	36.8%	10.4%	12.4%	31.2%	17.9%
2012	WI	23,476	8.2%	23.4%	6.9%	6.0%	29.8%	45.0%	33.4%	31.6%	41.7%	24.0%	39.9%	41.7%	20.3%	7.6%	19.8%	20.7%
2012	WY	2,359	4.8%	0.0%	6.2%	2.7%	27.1%	58.3%	37.5%	27.6%	31.6%	13.4%	36.0%	39.6%	36.4%	28.4%	20.3%	30.1%
2012	National	1,207,725	11.2%	19.0%	10.2%	6.8%	31.4%	41.6%	29.2%	33.5%	37.1%	26.8%	40.1%	39.4%	20.4%	12.6%	20.6%	20.4%

11. APPENDIX D. BISG ASSUMPTIONS USED BY CHARLES RIVER ASSOCIATES FOR THIS STUDY

BISG Assumptions	
Issue	CRA
Geography	2010 Census
Level	Tract
Population	18+
Co-buyers	Yes
Missing / Invalid geography	No BISG
Surname	2000 Census
Probabilities > 1	subtract from all equally
Suppressed probabilities	allocate equally across missing
Not suppressed, sum probabilities > .99 and < 1.0	allocate equally across all
Not suppressed, one probability = .99 (all others = 0)	allocate .01 across 5 missing
Compound names	match on: 1) whole name, 2) left of hyphen, 3) right of hyphen. keep first match
Hyphenated names	match on: 1) whole name, 2) 1 st compound, 3) 2 nd compound. keep first match
No matches	average probability of names not listed as reported by Elliott, Marc et al (2009)
BISG	
Multiple BISG vectors due to buyer and cobuyer	continuous = select vector with single highest minority probability; threshold = if relevant probability in any vector exceeds threshold, consider threshold to be met
Tie breakers	waterfall

12. APPENDIX E. RACE/ETHNICITY PROXIES: DIFFERENCES BETWEEN BIGG CALCULATIONS: CRA V. CFPB

Recently, the CFPB disclosed for the first time the assumptions it makes to estimate the race/ethnicity associated with indirect auto applications and contracts.¹⁴¹ For purposes of this study, CRA estimated the race/ethnicity of such applications and contracts using the same method and publicly available data sources as the CFPB, except as noted below.

Last Name Race/Ethnicity Probabilities

The surname probabilities of surnames occurring 100 or more times from the 2000 census ("Surname List") is used by both the CFPB and CRA as the basis of the surname race/ethnicity probabilities.¹⁴² For many surnames, this data file does not provide a set of race/ethnicity probabilities that sum up to one. The CFPB makes only one type of data correction: it distributes the sum of the suppressed race/ethnicity probabilities evenly across all categories with missing non-zero race/ethnicity counts. To fill in missing probabilities due to confidentiality concerns, and to address the rounding to four decimals of precisions issue in the Surname List, CRA modifies the surname probabilities file as follows:

- If a surname had suppressed probabilities, and the probabilities sum to less than one, then we allocate the remaining probability equally across all redacted probabilities.
- If a surname had no suppressed probabilities, and the probabilities sum to less than one, but not to 0.99, then we allocate the remaining probability equally across all race/ethnicities (including to those with zero probability).
- If a surname had no suppressed probabilities, and had the probabilities sum up to 0.99, then we allocate the remaining 0.01 probability equally across all five race/ethnicities with zero probabilities.¹⁴³

¹⁴¹ Op. Cit., CFPB, Summer 2014, available at <http://www.consumerfinance.gov/reports/using-publicly-available-information-to-proxy-for-unidentified-race-and-ethnicity/>, last accessed on 9/18/2014.

¹⁴² The file contains 151,671 surnames, and is available at <http://www.census.gov/genalogy/www/data/2000surnames/index.html>; last accessed on 3/30/2012.

¹⁴³ These were cases when one race/ethnicity was equal to 0.99 and the other five groups were all equal to zero.

- If a surname had race/ethnicity probabilities totaling more than one, then CRA subtracts the surplus equally across all non-zero race/ethnicities probabilities.

Surname manipulation: The CFPB and CRA use similar, but not exactly the same surname data cleaning. The differences could be driven by the particulars of the data used and could result in exactly the same cleaned surnames. The CFPB removes [] " characters. Then it converts to uppercase certain characters: { } , ' , and any digit. Then certain suffixes embedded into spaces are converted to space: JR SR III IV DDS MD PHD. Then single letters embedded in spaces are removed. Then spaces are removed. CRA removes certain characters: ' ' * , _ _ space and certain prefixes from the end of a last name (JR SR III III IV) when they are preceded by a space or a comma.

The CFPB splits hyphenated last names into two names. The two name components are tried for matching with a surname in the Surname List only separately, but not combined. For hyphenated last names, CRA uses not only the two name components, but also the combined name.

The CFBP is using the surname probabilities in this order: the probabilities from the applicant before hyphen (*if present*), then the probabilities from the applicant after hyphen (*if present*), then probabilities from the co-applicant before hyphen (*if present*), then the probabilities from the co-applicant after hyphen (*if present*). Only the first of these potential four names that can be matched to a name in the Surname List is used; all others are ignored. If no name or name component of a hyphenated name is matched to a name in the Surname List, no BISG probabilities are calculated. CRA calculates BISG probabilities separately for the applicant and the co-applicant (*if present*). For hyphenated surnames, we use the combined name (without hyphen) if that name exists in the Surname List. If it does not exist, we use the name before hyphen (*if present*). If that name component cannot be matched to a name in the Surname List, we use the name component after the hyphen (*if present*). If no name or name component exists in the Surname List, we use the probabilities of the names not listed in the Surname List as reported in Elliott, Marc N. et al (2009).¹⁴ We adjust these probabilities proportionally to sum to one (the “average surname probabilities”).¹⁵

144 On p. 73.

¹⁴⁵ After rounding each race/ethnicity category to four decimals, we changed the category with the largest probability so that the probabilities sum to one. The resulting probabilities were 69.38% for non-Hispanic white only, 11.12% for non-Hispanic black or African American only, 10.93% for Hispanics, 6.89% for non-Hispanic Asian only, and non-Hispanic Native Hawaiian and Other Pacific Islander only, 0.89% for non-Hispanic American Indian and Alaska Native only, and 0.79% for non-Hispanic two or more races.

Geography Race/Ethnicity Probabilities

Depending on the geocoding accuracy and the population in the geography level, the CFPB is using demographics at the census block group, census tract, and 5-digit zip code levels. CRA is using demographics only at the tract level. For the addresses identified by the geocoding provider as not sufficiently accurate (geocoded at the center of the state or the center of the U.S.), CRA does not create BISG probabilities.

In addition to specifically identified race categories, the respondents to the census may also identify as "Some Other Race". Most of those who selected "Some Other Race" also selected the Hispanic ethnicity. The CFPB "reallocate[s]" the "Some Other Race" counts to each of the remaining six race and ethnicity categories." CRA does not use the "Some Other Race."

BISG Probabilities

The CFPB is estimating a single BISG race/ethnicity probabilities vector. It is not clear whether it uses the address of the co-applicant, if present and different than the address of the primary applicant.

CRA is estimating BISG race/ethnicity probabilities separately for the applicant and the co-applicant (if present).

When using a threshold to determine if an application belongs to a particular race/ethnicity group, CRA considers an application to be of a given race/ethnicity if the estimated BISG probability for that race/ethnicity is greater than or equal to the specified threshold (e.g. 80%) for either the applicant or the co-applicant. For example, if an application has an applicant with an estimated BISG probability of being Hispanic of 82% and a co-applicant with an estimated BISG probability of being African American of 85%, the application would be included both as a Hispanic application and as an African American application. Applications are assigned to be non-Hispanic white if the non-Hispanic white BISG probability of any applicant or co-applicant name on the application is greater than or equal to the specified threshold, and the application is not categorized as being made by a member of a minority race/ethnicity. For example, if an application has an applicant with an estimated probability of being non-Hispanic white of 85% and a co-applicant with an estimated probability of being Hispanic of 83%, we do not categorize the application as non-Hispanic white.

When there is a co-applicant, for continuous race/ethnicity probabilities, CRA selects the race/ethnicity BISG probabilities given by the surname (or surname component as identified above) of the applicant or co-applicant that has the highest minority probability. For example, suppose we have an application for which we estimated the BISG probabilities as follows:

- o set A for the applicant given by 20% Hispanic, 70% white, 5% black, 3% AI/AN, 0% API, 2% multi-races

- set B for the co-applicant given by 15% Hispanic, 50% white, 25% black, 3% AI/AN, 0% API, 2% multi-races.

The largest minority probability across these sets is 25% black (from set B). CRA would then use set B for the race and ethnicity probabilities of the application.

- If there are ties for the largest minority probability across different probabilities sets, CRA decides which set of BMSG probabilities to use based on a "waterfall approach" in this order:

- applicant black
- co-applicant black
- applicant Hispanic
- co-applicant Hispanic
- applicant AI/AN
- co-applicant AI/AN
- applicant API
- co-applicant API
- applicant multi-races
- co-applicant multi-races.

13. APPENDIX F. BISG 2-WAY TABLES, "HEAT-MAPS"

Average African American BISG Probability by Surname and Tract Probability											
Surname Probability	0-10%	10-20%	20-30%	30-40%	40-50%	50-60%	60-70%	70-80%	80-90%	90-100%	
0-10%	0.4%	2.3%	4.8%	7.3%	10.8%	15.4%	20.7%	29.3%	43.5%	71.4%	
10-20%	3.8%	18.2%	30.4%	41.8%	52.4%	63.1%	72.6%	82.3%	90.0%	96.3%	
20-30%	6.9%	29.1%	44.5%	56.8%	67.0%	75.8%	82.8%	89.4%	94.2%	97.9%	
30-40%	10.7%	39.8%	56.4%	68.0%	76.5%	83.4%	88.5%	93.0%	96.2%	98.6%	
40-50%	16.3%	50.8%	66.7%	76.5%	83.5%	88.5%	92.3%	95.3%	97.3%	99.0%	
50-60%	22.1%	59.4%	74.0%	82.2%	87.6%	91.5%	94.1%	96.4%	98.0%	99.2%	
60-70%	31.6%	69.8%	81.5%	88.0%	91.8%	94.2%	96.0%	97.5%	98.5%	99.3%	
70-80%	44.2%	76.9%	87.6%	91.7%	94.4%	95.9%	97.1%	98.0%	98.7%	99.4%	
80-90%	63.3%	87.4%	92.6%	95.1%	96.8%	97.4%	98.1%	98.6%	99.1%	99.5%	
90-100%	80.6%	94.3%	96.8%	97.8%	98.5%	98.8%	99.2%	99.4%	99.5%	99.7%	
Average Hispanic BISG Probability by Surname and Tract Probability											
Surname Probability	0-10%	10-20%	20-30%	30-40%	40-50%	50-60%	60-70%	70-80%	80-90%	90-100%	
0-10%	0.3%	1.6%	3.0%	4.7%	7.2%	10.0%	14.6%	21.1%	34.2%	59.5%	
10-20%	3.6%	12.3%	21.1%	29.5%	39.8%	48.0%	59.2%	69.3%	81.5%	93.8%	
20-30%	6.8%	22.1%	34.5%	45.2%	56.3%	65.4%	74.3%	82.2%	89.5%	96.6%	
30-40%	10.9%	30.4%	44.9%	55.0%	65.2%	74.0%	81.7%	86.7%	93.1%	97.7%	
40-50%	15.8%	40.3%	55.4%	66.1%	74.4%	81.7%	87.1%	91.6%	95.6%	98.6%	
50-60%	23.7%	51.2%	65.5%	75.2%	81.7%	87.1%	91.1%	94.0%	97.0%	99.1%	
60-70%	31.9%	60.0%	73.2%	81.0%	86.4%	90.8%	94.1%	95.7%	97.8%	99.4%	
70-80%	44.8%	72.0%	82.4%	86.0%	92.0%	94.2%	96.2%	97.4%	98.7%	99.6%	
80-90%	62.5%	84.0%	90.6%	93.9%	95.9%	97.2%	98.2%	98.8%	99.4%	99.8%	
90-100%	75.1%	91.5%	95.4%	97.1%	98.1%	98.7%	99.2%	99.5%	99.7%	99.9%	

Source: CRA Contract Data

Average Asian BISG Probability by Surname and Tract Probability										
Surname Probability	Tract Probability									
	0-10%	10-20%	20-30%	30-40%	40-50%	50-60%	60-70%	70-80%	80-90%	90-100%
0-10%	0.3%	2.2%	4.4%	7.2%	10.7%	14.8%	20.2%	27.7%	43.9%	-
10-20%	7.8%	30.6%	44.6%	54.3%	62.7%	70.2%	78.0%	84.4%	81.3%	-
20-30%	14.9%	45.1%	58.7%	67.7%	76.0%	81.6%	86.5%	91.0%	93.8%	-
30-40%	21.5%	63.0%	74.4%	81.7%	88.2%	91.4%	94.4%	96.0%	97.2%	-
40-50%	32.5%	67.9%	77.4%	83.1%	86.4%	87.8%	91.4%	94.5%	96.1%	-
50-60%	42.4%	76.8%	84.6%	88.0%	87.8%	91.0%	92.5%	94.5%	95.0%	-
60-70%	53.5%	83.9%	90.2%	92.8%	94.5%	95.6%	95.9%	96.9%	97.3%	-
70-80%	65.8%	88.2%	92.0%	93.5%	94.5%	95.6%	97.2%	98.1%	98.5%	-
80-90%	78.8%	93.7%	95.9%	96.8%	96.8%	97.2%	97.5%	98.7%	99.5%	-
90-100%	90.2%	97.8%	98.7%	99.1%	99.3%	99.5%	99.6%	99.7%	99.9%	-
Average Non-Hispanic White BISG Probability by Surname and Tract Probability										
Surname Probability	Tract Probability									
	0-10%	10-20%	20-30%	30-40%	40-50%	50-60%	60-70%	70-80%	80-90%	90-100%
0-10%	0.1%	0.4%	0.8%	1.4%	2.1%	3.2%	4.8%	7.5%	13.0%	28.3%
10-20%	0.4%	1.2%	2.3%	3.9%	5.8%	8.7%	12.6%	19.1%	31.0%	55.3%
20-30%	0.7%	2.5%	4.8%	7.8%	11.1%	15.6%	22.2%	31.3%	46.8%	72.4%
30-40%	1.1%	4.1%	8.1%	11.7%	16.6%	22.4%	30.7%	41.8%	57.9%	81.1%
40-50%	1.5%	6.4%	11.8%	16.7%	23.6%	30.8%	40.5%	52.4%	68.6%	88.1%
50-60%	2.1%	9.2%	17.2%	23.3%	32.2%	40.7%	51.4%	62.7%	77.2%	92.1%
60-70%	3.1%	13.3%	23.7%	31.4%	41.5%	50.4%	60.9%	71.4%	83.4%	94.5%
70-80%	5.0%	20.0%	33.6%	42.6%	53.4%	61.9%	71.4%	79.9%	88.7%	96.3%
80-90%	8.9%	33.3%	49.6%	59.5%	69.1%	76.2%	82.8%	88.3%	93.5%	97.7%
90-100%	37.1%	66.3%	78.6%	84.9%	89.2%	92.2%	94.5%	96.2%	97.8%	99.1%

14. APPENDIX G. BISG FALSE POSITIVES AND NEGATIVES BY TRACT, FICO, INCOME, AND LMI

BISG Errors by Geographic Tract												
BISG Threshold		Geographic Tract Probability										
Race/Ethnicity	0 - 10%	10 - 20%	20 - 30%	30 - 40%	40 - 50%	50 - 60%	60 - 70%	70 - 80%	80 - 90%	90 - 100%	Total	
Not Identified by Proxy (False Negatives)												
African American	BISG ≥ 50%	94.4%	81.7%	57.4%	31.0%	18.5%	6.7%	2.5%	1.8%	1.6%	0.1%	51.8%
	BISG ≥ 80%	98.0%	95.7%	92.6%	86.2%	78.0%	56.3%	36.4%	18.0%	5.4%	1.0%	75.8%
Hispanic	BISG ≥ 50%	49.1%	29.2%	22.2%	20.0%	18.6%	14.7%	7.7%	5.3%	4.8%	0.9%	28.0%
	BISG ≥ 80%	81.6%	36.7%	25.6%	22.1%	20.2%	16.2%	18.1%	15.0%	12.2%	3.2%	41.4%
Asian	BISG ≥ 50%	50.8%	31.2%	28.6%	26.7%	7.8%	9.2%	12.9%	15.0%	0.0%	0.0%	40.4%
	BISG ≥ 80%	62.1%	38.0%	32.9%	29.6%	26.6%	23.6%	22.6%	22.5%	0.0%	0.0%	49.7%
Non-Hispanic White	BISG ≥ 50%	84.0%	61.4%	48.0%	41.5%	29.6%	15.7%	8.5%	3.6%	1.6%	0.8%	6.5%
	BISG ≥ 80%	98.4%	92.5%	81.4%	68.8%	60.0%	51.8%	43.1%	30.6%	10.0%	1.5%	22.3%
Wrongly Included (False Positives)												
African American	BISG ≥ 50%	38.2%	50.9%	55.1%	52.3%	51.0%	44.7%	40.2%	30.8%	21.4%	12.4%	43.6%
	BISG ≥ 80%	14.7%	21.9%	22.6%	26.6%	30.5%	27.5%	29.1%	24.4%	19.6%	11.5%	22.4%
Hispanic	BISG ≥ 50%	27.9%	20.1%	15.1%	14.1%	13.4%	10.6%	15.7%	13.5%	12.8%	10.8%	18.3%
	BISG ≥ 80%	22.6%	18.0%	13.5%	12.6%	11.6%	8.7%	6.2%	6.8%	7.4%	6.6%	13.2%
Asian	BISG ≥ 50%	24.0%	18.8%	14.6%	14.4%	25.0%	19.4%	17.6%	10.5%	16.7%	20.8%	20.8%
	BISG ≥ 80%	17.3%	14.5%	11.9%	9.7%	8.9%	6.3%	2.0%	6.1%	9.1%	14.2%	14.2%
Non-Hispanic White	BISG ≥ 50%	13.2%	17.7%	15.5%	14.9%	15.2%	15.7%	13.8%	11.1%	7.4%	4.0%	8.8%
	BISG ≥ 80%	13.3%	7.9%	9.0%	8.4%	8.4%	7.6%	7.2%	6.7%	6.2%	3.5%	5.6%

Source: HMDA enhanced with proprietary data

Race/Ethnicity		BISG Threshold	BISG Errors by FICO Score										Total
			FICO Score										
Not Identified by Proxy (False Negatives)													
African American	BISG ≥ 50%	43.0%	46.8%	46.6%	46.8%	52.3%	56.5%	58.1%	58.7%	51.8%			
	BISG ≥ 80%	69.6%	70.9%	71.4%	73.8%	77.0%	79.8%	79.5%	80.8%	75.8%			
Hispanic	BISG ≥ 50%	38.9%	23.8%	28.9%	20.8%	24.3%	28.2%	32.8%	32.7%	28.0%			
	BISG ≥ 80%	50.0%	33.8%	43.1%	31.3%	36.6%	42.8%	46.4%	48.3%	41.4%			
Asian	BISG ≥ 50%	100.0%	60.0%	68.6%	56.5%	54.3%	46.4%	38.0%	38.9%	40.4%			
	BISG ≥ 80%	100.0%	73.3%	77.1%	67.9%	66.1%	54.9%	47.9%	46.3%	49.7%			
Non-Hispanic White	BISG ≥ 50%	7.8%	9.9%	8.9%	8.3%	8.1%	6.6%	5.8%	5.1%	6.5%			
	BISG ≥ 80%	25.3%	28.7%	28.4%	26.4%	25.2%	23.0%	21.0%	19.6%	22.3%			
Wrongly Included (False Positives)													
African American	BISG ≥ 50%	19.6%	26.9%	22.5%	25.1%	37.2%	46.7%	59.8%	64.7%	43.6%			
	BISG ≥ 80%	11.1%	12.3%	12.4%	11.1%	18.9%	24.5%	33.5%	39.9%	22.4%			
Hispanic	BISG ≥ 50%	21.4%	17.6%	14.1%	12.9%	16.2%	18.5%	21.3%	23.2%	18.3%			
	BISG ≥ 80%	25.0%	13.1%	9.9%	10.0%	11.7%	13.7%	15.3%	16.3%	13.2%			
Asian	BISG ≥ 50%	100.0%	14.3%	26.7%	30.2%	29.5%	24.3%	20.2%	21.5%	20.8%			
	BISG ≥ 80%	100.0%	20.0%	27.3%	19.4%	19.2%	17.4%	14.6%	13.8%	14.2%			
Non-Hispanic White	BISG ≥ 50%	22.4%	20.6%	21.5%	16.9%	12.7%	9.3%	6.4%	5.1%	8.8%			
	BISG ≥ 80%	10.9%	10.5%	12.4%	9.8%	7.9%	6.2%	4.4%	3.4%	5.6%			

Source: HMDA enhanced with proprietary data

		BISG Errors by Income									
		Income									
		\$0 -	\$25,000 -	\$50,000 -	\$75,000 -	\$100,000 -	\$125,000 -	\$150,000 -	\$175,000 -	\$200,000 -	Total
Race/Ethnicity		\$0 -	\$25,000 -	\$50,000 -	\$75,000 -	\$100,000 -	\$125,000 -	\$150,000 -	\$175,000 -	\$200,000 -	Total
Not Identified by Proxy (False Negatives)											
African American	BISG ≥ 50%	29.6%	40.3%	67.8%	75.3%	79.1%	80.1%	81.9%	83.4%	85.1%	51.8%
	BISG ≥ 80%	55.6%	67.8%	75.3%	79.1%	80.1%	81.9%	83.4%	85.1%	86.8%	75.8%
	BISG ≥ 50%	18.7%	22.3%	32.6%	36.5%	44.1%	46.0%	48.3%	55.0%	55.0%	41.4%
	BISG ≥ 80%	29.5%	32.6%	36.5%	41.9%	41.9%	41.9%	41.9%	41.9%	41.9%	40.4%
Hispanic	BISG ≥ 50%	44.0%	39.2%	48.5%	50.8%	51.3%	45.7%	45.4%	43.4%	49.7%	49.7%
	BISG ≥ 80%	53.6%	48.5%	50.8%	51.3%	51.3%	45.7%	45.4%	43.4%	49.7%	49.7%
	BISG ≥ 50%	9.7%	7.9%	7.0%	23.6%	21.7%	20.9%	20.3%	17.6%	17.6%	22.3%
	BISG ≥ 80%	27.7%	25.1%	23.6%	21.7%	21.7%	20.9%	20.3%	17.6%	17.6%	22.3%
Wrongly Included (False Positives)											
African American	BISG ≥ 50%	35.7%	39.4%	45.3%	48.3%	48.3%	48.9%	53.8%	56.5%	56.5%	43.6%
	BISG ≥ 80%	17.9%	19.5%	23.9%	27.5%	27.5%	26.0%	30.9%	33.1%	33.1%	22.4%
	BISG ≥ 50%	11.0%	14.5%	16.9%	20.4%	20.4%	21.9%	25.4%	25.7%	25.7%	18.3%
	BISG ≥ 80%	8.0%	10.4%	11.8%	14.9%	14.9%	16.3%	18.4%	18.3%	18.3%	13.2%
Hispanic	BISG ≥ 50%	20.9%	22.2%	20.7%	19.7%	19.7%	20.2%	19.3%	20.8%	20.8%	20.8%
	BISG ≥ 80%	12.1%	14.5%	14.1%	14.6%	14.6%	14.8%	13.8%	14.2%	14.2%	14.2%
	BISG ≥ 50%	9.1%	8.6%	8.6%	8.2%	8.2%	7.9%	7.8%	6.3%	6.3%	8.8%
	BISG ≥ 80%	5.3%	5.4%	5.4%	5.2%	5.2%	5.1%	5.4%	4.3%	4.3%	5.6%

Source: HMDA enhanced with proprietary data

BISG Errors by Low-Moderate-Income Tract (LMI)						
Race/Ethnicity	BISG Threshold	LMI				
		Less than 50%	50% to 80%	80% to 120%	120% or More	Total
Not Identified by Proxy (False Negatives)						
African American	BISG ≥ 50%	9.4%	24.9%	51.3%	71.9%	51.8%
	BISG ≥ 80%	22.7%	54.1%	78.4%	90.3%	75.8%
Hispanic	BISG ≥ 50%	16.7%	20.5%	28.3%	31.0%	28.0%
	BISG ≥ 80%	24.7%	27.8%	41.6%	47.0%	41.4%
Asian	BISG ≥ 50%	33.3%	36.2%	44.3%	38.9%	40.4%
	BISG ≥ 80%	47.8%	46.3%	53.9%	47.8%	49.7%
Non-Hispanic White	BISG ≥ 50%	36.8%	16.6%	6.5%	4.0%	6.5%
	BISG ≥ 80%	63.9%	39.9%	22.9%	17.8%	22.3%
Wrongly Included (False Positives)						
African American	BISG ≥ 50%	41.3%	44.2%	43.3%	44.3%	43.6%
	BISG ≥ 80%	24.8%	25.4%	19.8%	19.1%	22.4%
Hispanic	BISG ≥ 50%	19.4%	16.4%	17.9%	19.5%	18.3%
	BISG ≥ 80%	11.6%	10.6%	13.3%	14.5%	13.2%
Asian	BISG ≥ 50%	16.5%	15.7%	20.2%	22.3%	20.8%
	BISG ≥ 80%	9.8%	10.4%	12.5%	16.1%	14.2%
Non-Hispanic White	BISG ≥ 50%	7.2%	8.8%	8.8%	8.8%	8.8%
	BISG ≥ 80%	4.1%	5.3%	5.4%	5.8%	5.6%

Source: HMDA, enhanced with proprietary data

15. APPENDIX H. CRA CONTRACT DATA VARIABLES

- 1 New/Used indicator
- 2 Term
- 3 Amount Financed
- 4 Finance charge (monthly payment * term – amount financed)
- 5 Total of payments
- 6 Contract rate
- 7 Monthly payment
- 8 Indicator that credit protection is on contract
- 9 Indicator that GAP is on contract
- 10 Indicator that extended service contract is on contract
- 11 Buyer Income
- 12 Indicator that Co-buyer is present on contract
- 13 Co-buyer income
- 14 Buyer FICO
- 15 Co-buyer FICO
- 16 Buyer age
- 17 Final Buy rate to dealer
- 18 Advance percentage (e.g. LTV)
- 19 Cash rebate amount
- 20 Dealer ID

16. APPENDIX I. CRA CONTRACT DATA DESCRIPTIVE STATISTICS

CRA Contract Data - Summary Statistics										
Credit Tranche	Characteristic	New Vehicle Contracts - Entire Sample								
		Count	Count with Data	Average	Minimum	1st Quartile	Median	3rd Quartile	Max	
All	Contract Amount (\$)	5,494,614	5,494,421	26,153	1,000	19,311	24,859	31,655	250,000	
	Term (Months)	5,494,614	5,481,864	64	12	60	66	72	84	
	Buy Rate	5,494,614	5,481,743	3.79	0.00	1.76	2.90	4.65	26.99	
	Contract Rate	5,494,614	5,483,308	4.46	0.00	1.90	3.74	5.85	27.99	
	Dealer Reserve (BPS)	5,494,614	5,453,190	66	0	0	0	150	300	
	Dealer Reserve (\$)	5,494,614	5,441,354	541	0	0	0	1,008	20,550	
	LTV (%)	5,494,614	5,220,279	88.39	0.03	73.00	92.00	106.72	298.00	
	PTI (%)	5,494,614	4,374,153	8.38	0.06	4.78	7.44	11.07	99.98	
	African American (%)	5,494,614	5,457,547	10.80%	0.00%	0.10%	1.09%	9.20%	100.00%	
	Hispanic (%)	5,494,614	5,457,547	12.30%	0.00%	0.17%	0.58%	2.94%	100.00%	
	Asian (%)	5,494,614	5,457,547	5.59%	0.00%	0.04%	0.18%	0.88%	99.98%	
	Non-Hispanic White (%)	5,494,614	5,457,547	69.22%	0.00%	45.72%	88.61%	97.28%	100.00%	
	Contract Amount (\$)	2,321,254	2,321,112	24,278	1,000	17,047	23,081	30,041	250,000	
	Term (Months)	2,321,254	2,313,881	60	12	60	60	72	84	
Credit Score ≥ 760	Buy Rate	2,321,254	2,308,204	2.05	0.00	0.90	1.90	2.99	18.72	
	Contract Rate	2,321,254	2,316,351	2.60	0.00	0.90	2.44	3.99	20.47	
	Dealer Reserve (BPS)	2,321,254	2,308,168	55	0	0	0	104	300	
	Dealer Reserve (\$)	2,321,254	2,300,771	376	0	0	0	583	20,550	
	LTV (%)	2,321,254	2,208,526	76.24	0.34	59.24	79.61	95.00	298.00	
	PTI (%)	2,321,254	1,788,171	6.82	0.07	3.85	5.85	8.72	99.83	



November 19, 2014

American Financial Services Association

720 ≤ Credit Score < 760	African American (%)	2,321,254	2,307,361	7.21%	0.00%	0.08%	0.79%	5.68%	99.99%
	Hispanic (%)	2,321,254	2,307,361	6.90%	0.00%	0.15%	0.43%	1.67%	100.00%
	Asian (%)	2,321,254	2,307,361	5.93%	0.00%	0.05%	0.19%	0.90%	99.98%
	Non-Hispanic White (%)	2,321,254	2,307,361	78.13%	0.00%	73.78%	93.55%	98.07%	100.00%
	Contract Amount (\$)	744,055	744,017	27.10%	1.00%	19,782	25,577	32,855	248,695
	Term (Months)	744,055	740,887	64	12	60	61	72	84
	Buy Rate	744,055	738,282	2.42	0.00	1.34	2.49	3.45	24.93
	Contract Rate	744,055	741,944	3.03	0.00	1.64	2.99	4.49	24.93
	Dealer Reserve (BPS)	744,055	738,269	61	0	0	0	130	300
	Dealer Reserve (\$)	744,055	735,102	508	0	0	0	900	16,156
	LTV (%)	744,055	698,900	88.07	0.58	74.26	91.00	104.00	197.44
	PTI (%)	744,055	569,305	7.64	0.06	4.45	6.73	9.90	97.63
	African American (%)	744,055	739,172	8.99%	0.00%	0.09%	0.94%	7.47%	100.00%
	Hispanic (%)	744,055	739,172	12.39%	0.00%	0.18%	0.62%	3.15%	100.00%
	Asian (%)	744,055	739,172	7.46%	0.00%	0.05%	0.21%	1.17%	99.98%
680 ≤ Credit Score < 720	Non-Hispanic White (%)	744,055	739,172	69.09%	0.00%	45.82%	88.54%	97.19%	100.00%
	Contract Amount (\$)	721,978	721,969	28,356	1.00	21,107	26,808	33,946	250,000
	Term (Months)	721,978	720,829	67	12	60	72	72	84
	Buy Rate	721,978	716,017	3.18	0.00	1.90	3.09	4.29	23.99
	Contract Rate	721,978	719,837	3.84	0.00	1.90	3.90	5.50	23.99
	Dealer Reserve (BPS)	721,978	715,979	67	0	0	0	150	297
	Dealer Reserve (\$)	721,978	714,833	608	0	0	0	1,160	14,851
	LTV (%)	721,978	680,393	96.00	0.94	83.00	98.00	111.67	190.82
	PTI (%)	721,978	572,198	8.51	0.07	6.16	7.70	11.07	99.85
	African American (%)	721,978	717,695	11.03%	0.00%	0.10%	1.14%	9.80%	100.00%
	Hispanic (%)	721,978	717,695	16.14%	0.00%	0.20%	0.76%	5.07%	100.00%
	Asian (%)	721,978	717,695	6.46%	0.00%	0.05%	0.20%	1.05%	99.98%

640 ≤ Credit Score < 680	Non-Hispanic White (%)	721.978	717.695	64.18%	0.00%	24.98%	83.84%	96.44%	100.00%
	Contract Amount (\$)	655,063	655,063	28,860	1,396	21,905	27,308	34,118	233,887
	Term (Months)	655,063	654,933	69	12	66	72	72	84
	Buy Rate	655,063	651,477	4.79	0.00	2.90	4.60	6.58	24.34
	Contract Rate	655,063	653,974	5.60	0.00	2.90	5.69	7.75	24.99
	Dealer Reserve (BPS)	655,063	651,115	81	0	0	50	152	300
	Dealer Reserve (\$)	655,063	651,010	764	0	0	377	1,440	13,327
	LTV (%)	655,063	621,124	102.17	0.03	90.28	104.00	117.00	200.00
	PTI (%)	655,063	546,994	9.63	0.12	6.16	9.01	12.48	99.77
	African American (%)	655,063	651,183	14.00%	0.00%	0.13%	1.51%	14.32%	100.00%
	Hispanic (%)	655,063	651,183	18.24%	0.00%	0.21%	0.83%	6.90%	100.00%
	Asian (%)	655,063	651,183	4.64%	0.00%	0.04%	0.16%	0.79%	99.98%
	Non-Hispanic White (%)	655,063	651,183	60.84%	0.00%	15.92%	78.95%	95.76%	100.00%
	Contract Amount (\$)	464,997	464,997	27,745	1,300	21,381	26,238	32,389	171,407
600 ≤ Credit Score < 640	Term (Months)	464,997	464,884	70	12	72	72	72	84
	Buy Rate	464,997	463,087	7.07	0.00	3.94	6.99	9.58	25.99
	Contract Rate	464,997	464,498	7.95	0.00	4.90	7.99	10.90	25.99
	Dealer Reserve (BPS)	464,997	461,721	87	0	0	74	200	291
	Dealer Reserve (\$)	464,997	461,712	805	0	0	548	1,516	10,456
	LTV (%)	464,997	443,931	103.45	2.72	93.00	105.70	117.00	187.90
	PTI (%)	464,997	395,582	10.68	0.16	7.12	10.19	13.61	99.85
	African American (%)	464,997	460,903	16.97%	0.00%	0.15%	2.09%	20.53%	99.99%
	Hispanic (%)	464,997	460,903	18.73%	0.00%	0.21%	0.85%	7.36%	100.00%
	Asian (%)	464,997	460,903	3.48%	0.00%	0.04%	0.15%	0.66%	99.97%
	Non-Hispanic White (%)	464,997	460,903	58.42%	0.00%	12.33%	74.32%	94.98%	100.00%
	Contract Amount (\$)	529,158	529,157	25,795	1,755	20,278	24,401	29,777	137,967
	Term (Months)	529,158	528,405	70	12	72	72	72	84



November 19, 2014 American Financial Services Association

Credit Score < 600	Buy Rate	529,158	527,270	9.96	0.00	6.90	10.00	12.95	26.99
	Contract Rate	529,158	528,758	10.90	0.00	7.90	11.20	14.49	27.99
	Dealer Reserve (BPS)	529,158	520,742	81	0	0	24	200	299
	Dealer Reserve (\$)	529,158	520,739	725	0	0	182	1,423	8,711
	LTV (%)	529,158	514,288	102.41	1.35	93.08	104.32	115.00	192.49
	PTI (%)	529,158	470,344	11.53	0.21	7.96	11.00	14.12	99.98
	African American (%)	529,158	523,339	19.53%	0.00%	0.19%	3.00%	27.20%	100.00%
	Hispanic (%)	529,158	523,339	17.44%	0.00%	0.21%	0.82%	5.82%	100.00%
	Asian (%)	529,158	523,339	2.47%	0.00%	0.04%	0.14%	0.57%	99.97%
	Non-Hispanic White (%)	529,158	523,339	57.93%	0.00%	13.15%	72.54%	94.55%	100.00%
	Contract Amount (\$)	58,109	58,106	21,482	1,000	15,434	20,084	26,337	150,000
	Term (Months)	58,109	58,045	58	12	60	60	64	84
	Buy Rate	58,109	57,406	4.45	0.00	1.90	3.79	6.90	20.99
	Contract Rate	58,109	57,946	5.18	0.00	1.90	3.99	8.45	21.99
Unknown / Invalid Credit Score	Dealer Reserve (BPS)	58,109	57,196	70	0	0	0	166	289
	Dealer Reserve (\$)	58,109	57,187	414	0	0	0	785	6,404
	LTV (%)	58,109	53,117	77.37	1.63	61.00	82.00	96.00	264.00
	PTI (%)	58,109	31,659	10.20	0.16	6.10	9.51	13.47	62.43
	African American (%)	58,109	57,894	10.36%	0.00%	0.13%	1.38%	8.96%	100.00%
	Hispanic (%)	58,109	57,894	14.03%	0.00%	0.22%	1.12%	6.45%	100.00%
	Asian (%)	58,109	57,894	13.13%	0.00%	0.08%	0.59%	5.72%	99.97%
	Non-Hispanic White (%)	58,109	57,894	60.33%	0.00%	18.33%	76.76%	94.54%	100.00%
	Buy Rate	58,109	57,406	4.45	0.00	1.90	3.79	6.90	20.99
	Contract Rate	58,109	57,946	5.18	0.00	1.90	3.99	8.45	21.99
	Dealer Reserve (BPS)	58,109	57,196	70	0	0	0	166	289
	Dealer Reserve (\$)	58,109	57,187	414	0	0	0	785	6,404
	LTV (%)	58,109	53,117	77.37	1.63	61.00	82.00	96.00	264.00
	PTI (%)	58,109	31,659	10.20	0.16	6.10	9.51	13.47	62.43
	African American (%)	58,109	57,894	10.36%	0.00%	0.13%	1.38%	8.96%	100.00%
	Hispanic (%)	58,109	57,894	14.03%	0.00%	0.22%	1.12%	6.45%	100.00%
	Asian (%)	58,109	57,894	13.13%	0.00%	0.08%	0.59%	5.72%	99.97%
	Non-Hispanic White (%)	58,109	57,894	60.33%	0.00%	18.33%	76.76%	94.54%	100.00%

CRA Contract Data - Summary Statistics											
Credit Tranche	New Vehicle Contracts - Dealer Reserve Sample (Excluding Subvented Contracts)										
	Characteristic	Count	Count with Data	Average	Minimum	1st Quartile	Median	3rd Quartile	Max		
All	Contract Amount (\$)	3,269,485	3,269,485	25,525	1,000	18,877	24,454	31,116	249,289		
	Term (Months)	3,269,485	3,269,485	66	12	60	72	72	84		
	Buy Rate	3,269,485	3,269,485	4.98	0.04	2.74	3.74	5.89	26.99		
	Contract Rate	3,269,485	3,269,485	6.07	0.04	3.60	4.99	7.28	27.99		
	Dealer Reserve (BPS)	3,269,485	3,269,485	110	0	0	113	200	300		
	Dealer Reserve (\$)	3,269,485	3,269,485	900	0	0	782	1,473	20,550		
	LTV (%)	3,269,485	3,118,715	87.90	0.34	71.24	92.00	108.00	264.00		
	PTI (%)	3,269,485	2,718,476	8.56	0.07	4.87	7.71	11.34	99.85		
	African American (%)	3,269,485	3,241,261	11.72%	0.00%	0.11%	1.24%	10.73%	100.00%		
	Hispanic (%)	3,269,485	3,241,261	13.29%	0.00%	0.18%	0.61%	3.22%	100.00%		
	Asian (%)	3,269,485	3,241,261	4.11%	0.00%	0.04%	0.15%	0.89%	99.86%		
	Non-Hispanic White (%)	3,269,485	3,241,261	68.79%	0.00%	44.25%	88.04%	97.18%	100.00%		
Credit Score ≥ 760	Contract Amount (\$)	1,280,219	1,280,219	23,429	1,000	15,946	22,452	29,610	249,269		
	Term (Months)	1,280,219	1,280,219	62	12	60	60	72	84		
	Buy Rate	1,280,219	1,280,219	2.91	0.09	2.29	2.89	3.64	18.72		
	Contract Rate	1,280,219	1,280,219	3.90	0.09	2.90	3.89	4.94	20.47		
	Dealer Reserve (BPS)	1,280,219	1,280,219	99	0	0	100	190	300		
	Dealer Reserve (\$)	1,280,219	1,280,219	676	0	0	481	1,091	20,550		
	LTV (%)	1,280,219	1,223,089	73.47	0.34	53.92	76.62	93.64	194.57		
	PTI (%)	1,280,219	1,002,864	6.81	0.07	3.86	5.90	8.76	99.83		
	African American (%)	1,280,219	1,269,931	7.90%	0.00%	0.08%	0.88%	6.61%	99.99%		
	Hispanic (%)	1,280,219	1,269,931	7.16%	0.00%	0.15%	0.43%	1.65%	100.00%		

	Asian (%)	1,280,219	1,269,931	3.83%	0.00%	0.04%	0.14%	0.62%	99.97%
	Non-Hispanic White (%)	1,280,219	1,269,931	79.29%	0.00%	75.52%	93.12%	98.12%	100.00%
	Contract Amount (\$)	443,860	443,860	26,846	1,000	19,557	25,584	32,883	220,906
	Term (Months)	443,860	443,860	67	12	60	72	72	84
	Buy Rate	443,860	443,860	3.24	0.15	2.49	3.09	3.79	24.93
	Contract Rate	443,860	443,860	4.26	0.15	3.14	3.99	4.99	24.93
	Dealer Reserve (BPS)	443,860	443,860	101	0	0	100	190	300
	Dealer Reserve (\$)	443,860	443,860	841	0	0	680	1,366	16,156
	LTV (%)	443,860	416,073	87.96	0.58	72.96	91.00	106.00	197.44
	PTI (%)	443,860	354,277	7.82	0.11	4.62	6.96	10.15	97.83
	African American (%)	443,860	440,737	9.92%	0.00%	0.10%	1.10%	8.86%	100.00%
	Hispanic (%)	443,860	440,737	13.41%	0.00%	0.18%	0.63%	3.34%	100.00%
	Asian (%)	443,860	440,737	5.09%	0.00%	0.04%	0.16%	0.78%	99.98%
	Non-Hispanic White (%)	443,860	440,737	69.53%	0.00%	48.16%	88.52%	97.16%	100.00%
	Contract Amount (\$)	443,620	443,620	28,098	1,000	21,084	26,786	33,760	240,220
	Term (Months)	443,620	443,620	69	12	72	72	75	84
	Buy Rate	443,620	443,620	4.18	0.04	3.06	3.84	4.95	23.99
	Contract Rate	443,620	443,620	5.26	0.04	3.99	4.99	6.24	23.99
	Dealer Reserve (BPS)	443,620	443,620	108	0	5	115	200	297
	Dealer Reserve (\$)	443,620	443,620	980	0	40	913	1,557	14,851
	LTV (%)	443,620	419,121	97.03	0.94	83.37	99.16	114.00	189.00
	PTI (%)	443,620	377,509	8.74	0.07	5.38	7.98	11.36	99.65
	African American (%)	443,620	441,067	11.98%	0.00%	0.11%	1.29%	11.33%	100.00%
	Hispanic (%)	443,620	441,067	17.38%	0.00%	0.21%	0.80%	5.93%	100.00%
	Asian (%)	443,620	441,067	4.72%	0.00%	0.04%	0.16%	0.79%	99.97%
	Non-Hispanic White (%)	443,620	441,067	63.76%	0.00%	23.82%	83.17%	96.31%	100.00%

November 19, 2014

American Financial Services Association

640 ≤ Credit Score < 680	Contract Amount (\$)	435,958	435,958	28,172	1,386	21,572	26,852	33,315	233,887
	Term (Months)	71	12			72	72	72	84
	Buy Rate	435,958	435,958	5.96	0.40	4.15	5.56	7.38	24.34
	Contract Rate	435,958	435,958	7.16	0.40	5.38	6.94	8.75	24.99
	Dealer Reserve (BPS)	435,958	435,958	120	0	50	150	200	300
	Dealer Reserve (\$)	435,958	435,958	1,141	0	380	1,164	1,728	13,327
	LTV (%)	435,958	420,733	102.19	0.96	90.00	104.61	118.00	200.00
	PTI (%)	435,958	388,675	9.78	0.15	6.35	9.21	12.66	99.77
	African American (%)	435,958	432,981	14.52%	0.00%	0.13%	1.59%	15.29%	100.00%
	Hispanic (%)	435,958	432,981	18.91%	0.00%	0.21%	0.87%	7.74%	100.00%
	Asian (%)	435,958	432,981	4.02%	0.00%	0.04%	0.16%	0.73%	99.97%
	Non-Hispanic White (%)	435,958	432,981	60.26%	0.00%	14.52%	78.09%	95.59%	100.00%
	Contract Amount (\$)	310,702	310,702	28,602	1,300	20,749	25,324	31,021	171,407
	Term (Months)	71	12			72	72	72	84
600 ≤ Credit Score < 640	Buy Rate	310,702	310,702	8.50	0.25	5.99	8.29	10.52	24.99
	Contract Rate	310,702	310,702	9.78	0.90	7.34	9.73	11.90	25.00
	Dealer Reserve (BPS)	310,702	310,702	129	0	65	150	200	291
	Dealer Reserve (\$)	310,702	310,702	1,196	0	509	1,259	1,771	10,456
	LTV (%)	310,702	297,883	102.34	2.72	91.69	104.87	116.66	185.00
	PTI (%)	310,702	277,673	10.89	0.16	7.22	10.27	13.68	99.85
	African American (%)	310,702	307,006	17.32%	0.00%	0.16%	2.16%	21.29%	99.98%
	Hispanic (%)	310,702	307,006	19.45%	0.00%	0.22%	0.92%	8.73%	100.00%
	Asian (%)	310,702	307,006	3.60%	0.00%	0.04%	0.16%	0.70%	99.97%
	Non-Hispanic White (%)	310,702	307,006	57.20%	0.00%	10.40%	72.11%	94.52%	100.00%
	Contract Amount (\$)	322,771	322,771	24,466	1,755	19,613	23,398	28,158	137,967
	Term (Months)	71	12			72	72	72	84

November 19, 2014

American Financial Services Association

Credit Score < 600	Buy Rate	322,771	322,771	11.79	0.90	9.05	11.49	14.50	26.99
	Contract Rate	322,771	322,771	13.09	0.90	10.54	12.95	15.85	27.99
	Dealer Reserve (BPS)	322,771	322,771	130	0	75	150	200	289
	Dealer Reserve (\$)	322,771	322,771	1,169	0	543	1,207	1,743	8,711
	LTV (%)	322,771	312,655	100.40	1.35	90.98	103.00	113.74	177.00
	PTI (%)	322,771	295,709	11.35	0.21	7.86	10.89	14.12	99.83
	African American (%)	322,771	317,229	20.04%	0.00%	0.21%	3.28%	28.51%	99.98%
	Hispanic (%)	322,771	317,229	18.04%	0.00%	0.23%	0.92%	6.80%	100.00%
	Asian (%)	322,771	317,229	2.82%	0.00%	0.04%	0.16%	0.66%	99.97%
	Non-Hispanic White (%)	322,771	317,229	56.53%	0.00%	11.26%	69.76%	93.84%	100.00%
	Contract Amount (\$)	32,355	32,355	19,643	1,000	13,780	18,750	23,990	150,000
	Term (Months)	32,355	32,355	60	12	60	60	72	84
	Buy Rate	32,355	32,355	6.33	0.40	3.84	6.04	8.25	20.99
	Contract Rate	32,355	32,355	7.57	0.99	4.85	7.29	9.99	21.99
Unknown / Invalid Credit Score	Dealer Reserve (BPS)	32,355	32,355	124	0	0	150	200	289
	Dealer Reserve (\$)	32,355	32,355	732	0	0	638	1,214	6,404
	LTV (%)	32,355	28,161	73.53	1.63	53.00	78.00	95.00	264.00
	PTI (%)	32,355	21,769	10.58	0.17	6.63	9.96	13.82	82.43
	African American (%)	32,355	32,310	10.76%	0.00%	0.10%	1.16%	9.11%	100.00%
	Hispanic (%)	32,355	32,310	16.00%	0.00%	0.19%	0.98%	7.42%	99.99%
	Asian (%)	32,355	32,310	11.99%	0.00%	0.05%	0.33%	3.81%	99.96%
	Non-Hispanic White (%)	32,355	32,310	59.11%	0.00%	12.59%	75.57%	95.28%	99.99%

CRA Contract Data - Summary Statistics										
Used Vehicle Contracts - Entire Sample										
Credit Tranche	Characteristic	Count	Count with Data	Average	Minimum	1st Quartile	Median	3rd Quartile	Max	
All	Contract Amount (\$)	2,720,283	2,720,264	19,041	1,032	13,965	17,803	22,844	249,999	
	Term (Months)	2,720,283	2,703,001	65	12	60	72	72	84	
	Buy Rate	2,720,283	2,684,402	8.43	0.00	3.67	7.14	12.34	37.79	
	Contract Rate	2,720,283	2,718,426	9.74	0.00	4.84	8.69	14.00	49.95	
	Dealer Reserve (BPS)	2,720,283	2,670,445	117	0	0	150	200	300	
	Dealer Reserve (\$)	2,720,283	2,666,060	730	0	0	694	1,167	15,504	
	LTV (%)	2,720,283	2,533,222	107.37	1.23	95.00	111.00	123.44	276.00	
	PTI (%)	2,720,283	2,422,714	8.76	0.05	5.26	8.03	11.52	99.42	
	African American (%)	2,720,283	2,672,951	15.56%	0.00%	0.15%	1.77%	16.74%	100.00%	
	Hispanic (%)	2,720,283	2,672,951	14.41%	0.00%	0.18%	0.65%	3.83%	100.00%	
	Asian (%)	2,720,283	2,672,951	2.97%	0.00%	0.04%	0.15%	0.66%	99.97%	
	Non-Hispanic White (%)	2,720,283	2,672,951	64.92%	0.00%	29.20%	84.01%	96.67%	100.00%	
	Contract Amount (\$)	496,880	496,864	19,166	1,050	13,181	17,758	23,382	249,999	
	Term (Months)	496,880	494,029	61	12	60	60	72	84	
	Buy Rate	496,880	493,309	2.96	0.00	1.92	2.89	3.54	24.99	
Credit Score ≥ 760	Contract Rate	496,880	496,378	3.79	0.00	2.59	3.50	4.84	24.99	
	Dealer Reserve (BPS)	496,880	493,277	83	0	0	60	155	299	
	Dealer Reserve (\$)	496,880	490,431	447	0	0	228	793	12,421	
	LTV (%)	496,880	458,035	94.17	1.23	76.93	96.00	112.61	236.70	
	PTI (%)	496,880	404,383	6.26	0.05	3.64	5.44	7.99	97.62	
	African American (%)	496,880	488,384	8.63%	0.00%	0.10%	1.00%	7.23%	100.00%	
	Hispanic (%)	496,880	488,384	8.55%	0.00%	0.16%	0.48%	1.99%	100.00%	
	Asian (%)	496,880	488,384	3.54%	0.00%	0.04%	0.17%	0.75%	99.97%	

720 ≤ Credit Score < 760	Non-Hispanic White (%)	496,880	488,384	77.30%	0.00%	71.30%	92.89%	97.96%	100.00%
	Contract Amount (\$)	260,708	260,707	19,964	1,564	14,054	18,556	24,292	248,864
	Term (Months)	260,708	259,628	64	12	60	66	72	84
	Buy Rate	260,708	258,838	3.84	0.00	2.65	3.44	4.58	24.99
	Contract Rate	260,708	260,447	4.83	0.00	3.09	4.54	5.90	25.80
	Dealer Reserve (BPS)	260,708	258,742	100	0	0	101	190	300
	Dealer Reserve (\$)	260,708	257,667	584	0	0	482	992	11,055
	LTV (%)	260,708	236,348	102.29	5.97	87.21	104.00	119.60	275.00
	PTI (%)	260,708	215,423	6.99	0.11	4.07	6.15	9.06	94.61
	African American (%)	260,708	256,366	10.82%	0.00%	0.12%	1.20%	9.39%	100.00%
	Hispanic (%)	260,708	256,366	13.44%	0.00%	0.18%	0.66%	3.59%	100.00%
	Asian (%)	260,708	256,366	4.24%	0.00%	0.04%	0.18%	0.87%	99.97%
	Non-Hispanic White (%)	260,708	256,366	69.49%	0.00%	47.04%	88.49%	97.19%	100.00%
	Contract Amount (\$)	346,356	346,356	20,204	1,032	14,486	18,866	24,537	234,613
680 ≤ Credit Score < 720	Term (Months)	346,356	345,892	66	12	60	72	72	84
	Buy Rate	346,356	344,230	5.31	0.00	3.50	4.84	6.45	24.99
	Contract Rate	346,356	346,011	6.43	0.00	4.49	5.99	7.89	25.00
	Dealer Reserve (BPS)	346,356	343,977	112	0	0	146	200	289
	Dealer Reserve (\$)	346,356	343,552	696	0	0	659	1,123	15,504
	LTV (%)	346,356	312,955	107.75	6.99	94.02	110.00	124.00	226.83
	PTI (%)	346,356	297,935	7.73	0.11	4.64	6.95	10.05	94.74
	African American (%)	346,356	341,605	12.99%	0.00%	0.12%	1.34%	12.10%	99.99%
	Hispanic (%)	346,356	341,605	15.94%	0.00%	0.19%	0.73%	4.87%	99.99%
	Asian (%)	346,356	341,605	3.73%	0.00%	0.04%	0.16%	0.77%	99.97%
	Non-Hispanic White (%)	346,356	341,605	65.26%	0.00%	29.35%	84.84%	96.75%	100.00%
	Contract Amount (\$)	460,286	460,286	19,865	1,483	14,587	18,620	23,978	162,346
	Term (Months)	460,286	459,976	67	12	60	72	72	84

November 19, 2014

American Financial Services Association

< 680	Buy Rate	450.286	458.275	7.80	0.00	5.39	7.35	9.53	24.99
	Contract Rate	460.286	459.992	9.11	0.00	6.65	8.75	11.05	25.99
	Dealer Reserve (BPS)	460.286	456.778	129	0	68	150	200	295
	Dealer Reserve (\$)	460.286	456.746	830	0	291	829	1,248	13,015
	LTV (%)	460.286	425.001	111.72	1.47	100.00	114.62	126.00	216.10
	PTI (%)	460.286	419.782	8.70	0.11	5.46	8.04	11.29	99.02
	African American (%)	460.286	454.334	15.87%	0.00%	0.15%	1.79%	17.53%	100.00%
	Hispanic (%)	460.286	454.334	16.50%	0.00%	0.18%	0.71%	5.03%	100.00%
	Asian (%)	460.286	454.334	2.83%	0.00%	0.03%	0.14%	0.63%	99.97%
	Non-Hispanic White (%)	460.286	454.334	62.64%	0.00%	21.63%	81.20%	96.34%	100.00%
	Contract Amount (\$)	449.681	449.681	18,862	1,100	14,284	17,760	22,426	149,602
	Term (Months)	449.681	448.519	67	12	60	72	72	75
	Buy Rate	449.681	447.455	11.01	0.00	8.10	10.69	13.75	26.46
	Contract Rate	449.681	449.482	12.46	0.00	9.58	12.29	15.30	27.00
600 ≤ Credit Score < 640	Dealer Reserve (BPS)	449.681	443.997	138	0	100	152	200	300
	Dealer Reserve (\$)	449.681	443.995	888	0	419	892	1,307	8,898
	LTV (%)	449.681	423.613	112.71	1.38	102.06	115.62	125.00	206.83
	PTI (%)	449.681	420.441	9.87	0.18	6.45	9.30	12.67	99.36
	African American (%)	449.681	440.726	18.91%	0.00%	0.19%	2.59%	25.14%	100.00%
	Hispanic (%)	449.681	440.726	16.15%	0.00%	0.18%	0.71%	4.79%	100.00%
	Asian (%)	449.681	440.726	2.40%	0.00%	0.03%	0.14%	0.58%	99.97%
	Non-Hispanic White (%)	449.681	440.726	60.27%	0.00%	17.24%	76.90%	95.69%	100.00%
	Contract Amount (\$)	674.168	674.167	17,830	1,107	13,886	16,997	20,929	103,021
	Term (Months)	674.168	663.399	67	12	60	72	72	84
	Buy Rate	674.168	662.460	14.64	0.00	11.53	14.70	17.90	34.79
	Contract Rate	674.168	673.933	16.09	0.00	13.19	16.24	18.90	34.79
	Dealer Reserve (BPS)	674.168	655.095	131	0	90	150	200	297
Credit Score < 600									

November 19, 2014

American Financial Services Association

Unknown / Invalid Credit Score	Dealer Reserve (\$)	674,168	655,092	843	0	329	807	1,279	7,444
	LTV (%)	674,168	652,926	112.19	3.36	102.64	115.00	124.00	240.00
	PTI (%)	674,168	638,910	10.70	0.16	7.29	10.16	13.34	99.42
	African American (%)	674,168	659,541	21.30%	0.00%	0.23%	3.49%	32.31%	100.00%
	Hispanic (%)	674,168	659,541	15.23%	0.00%	0.19%	0.72%	4.31%	100.00%
	Asian (%)	674,168	659,541	2.03%	0.00%	0.04%	0.14%	0.56%	99.97%
	Non-Hispanic White (%)	674,168	659,541	59.05%	0.00%	16.27%	74.03%	95.18%	100.00%
	Contract Amount (\$)	32,204	32,203	13,159	1,064	8,613	12,050	16,363	225,576
	Term (Months)	32,204	31,558	53	12	42	54	60	75
	Buy Rate	32,204	19,835	7.51	0.00	4.09	7.29	9.70	37.79
	Contract Rate	32,204	32,183	15.26	0.00	7.99	12.79	22.99	49.95
	Dealer Reserve (BPS)	32,204	18,579	127	0	0	150	200	289
	Dealer Reserve (\$)	32,204	18,577	579	0	0	545	960	4,094
	LTV (%)	32,204	24,344	102.62	8.28	84.00	104.18	123.00	276.00
	PTI (%)	32,204	25,840	9.78	0.21	6.49	9.29	12.46	71.11
	African American (%)	32,204	31,995	14.48%	0.00%	0.10%	1.13%	13.05%	99.95%
	Hispanic (%)	32,204	31,995	24.78%	0.00%	0.28%	1.52%	40.93%	99.99%
	Asian (%)	32,204	31,995	5.24%	0.00%	0.05%	0.24%	1.35%	99.90%
	Non-Hispanic White (%)	32,204	31,995	53.49%	0.00%	5.30%	66.12%	93.85%	100.00%

CRA Contract Data - Summary Statistics											
Used Vehicle Contracts - Dealer Reserve Sample (Excluding Subvented Contracts)											
Credit Tranche	Characteristic	Count	Count with Data	Average	Minimum	1st Quartile	Median	3rd Quartile	Max		
All	Contract Amount (\$)	2,381,579	2,381,579	18,753	1,032	13,859	17,620	22,522	249,305		
	Term (Months)	2,381,579	2,381,579	66	12	60	72	72	84		
	Buy Rate	2,381,579	2,381,579	9.06	0.02	4.12	8.23	13.00	37.79		
	Contract Rate	2,381,579	2,381,579	10.37	0.64	5.49	9.69	14.60	37.79		
	Dealer Reserve (BPS)	2,381,579	2,381,579	132	0	76	150	200	300		
	Dealer Reserve (\$)	2,381,579	2,381,579	817	0	322	789	1,225	15,504		
	LTV (%)	2,381,579	2,212,268	109.10	1.47	97.25	112.55	124.00	255.00		
	PTI (%)	2,381,579	2,275,715	8.62	0.05	5.31	8.09	11.59	99.42		
	African American (%)	2,381,579	2,338,684	16.35%	0.00%	0.16%	1.97%	18.61%	100.00%		
	Hispanic (%)	2,381,579	2,338,684	14.65%	0.00%	0.18%	0.65%	3.87%	100.00%		
	Asian (%)	2,381,579	2,338,684	2.84%	0.00%	0.04%	0.14%	0.62%	99.97%		
	Non-Hispanic White (%)	2,381,579	2,338,684	64.00%	0.00%	26.47%	82.74%	96.51%	100.00%		
	Contract Amount (\$)	378,838	378,838	18,510	1,050	12,828	17,354	22,830	249,305		
	Term (Months)	378,838	378,838	62	12	60	60	72	84		
	Buy Rate	378,838	378,838	3.08	0.28	1.99	2.90	3.64	24.99		
	Contract Rate	378,838	378,838	4.16	0.64	2.90	3.99	4.99	24.99		
Credit Score ≥ 760	Dealer Reserve (BPS)	378,838	378,838	108	0	0	115	190	289		
	Dealer Reserve (\$)	378,838	378,838	579	0	0	487	933	12,421		
	LTV (%)	378,838	341,350	96.78	2.40	79.59	99.00	115.00	236.70		
	PTI (%)	378,838	361,709	6.19	0.05	3.61	5.40	7.92	97.62		
	African American (%)	378,838	371,840	9.68%	0.00%	0.11%	1.15%	8.45%	99.96%		
	Hispanic (%)	378,838	371,840	9.12%	0.00%	0.16%	0.47%	2.00%	100.00%		
	Asian (%)	378,838	371,840	3.42%	0.00%	0.04%	0.15%	0.66%	99.97%		

720 ≤ Credit Score < 760	Non-Hispanic White (%)	378.838	371.840	76.00%	0.00%	68.01%	92.22%	97.85%	100.00%
	Contract Amount (\$)	211,072	211,072	19,449	1,564	13,709	18,201	23,870	189,563
	Term (Months)	211,072	211,072	65	12	60	72	72	84
	Buy Rate	211,072	211,072	4.01	0.02	2.79	3.53	4.83	24.99
	Contract Rate	211,072	211,072	5.23	0.90	3.84	4.99	6.24	25.80
	Dealer Reserve (BPS)	211,072	211,072	122	0	33	150	200	300
	Dealer Reserve (\$)	211,072	211,072	713	0	132	668	1,097	11,055
	LTV (%)	211,072	187,435	104.56	5.97	90.00	107.00	121.88	255.00
	PTI (%)	211,072	198,204	6.96	0.11	4.05	6.12	9.03	94.51
	African American (%)	211,072	207,655	11.51%	0.00%	0.13%	1.32%	10.49%	100.00%
	Hispanic (%)	211,072	207,655	13.98%	0.00%	0.18%	0.84%	3.69%	100.00%
	Asian (%)	211,072	207,655	4.15%	0.00%	0.04%	0.17%	0.79%	99.97%
	Non-Hispanic White (%)	211,072	207,655	68.34%	0.00%	42.50%	87.57%	97.07%	100.00%
	Contract Amount (\$)	292,541	292,541	19,774	1,032	14,148	18,513	24,072	234,613
680 ≤ Credit Score < 720	Term (Months)	292,541	292,541	66	12	60	72	72	84
	Buy Rate	292,541	292,541	5.60	0.90	3.74	5.09	6.89	24.99
	Contract Rate	292,541	292,541	6.91	0.90	4.99	6.49	8.30	25.00
	Dealer Reserve (BPS)	292,541	292,541	132	0	76	150	200	289
	Dealer Reserve (\$)	292,541	292,541	818	0	340	794	1,203	15,504
	LTV (%)	292,541	260,070	109.72	6.99	97.00	112.01	125.63	226.83
	PTI (%)	292,541	276,759	7.74	0.11	4.65	6.95	10.06	94.74
	African American (%)	292,541	288,759	13.59%	0.00%	0.13%	1.43%	13.23%	99.99%
	Hispanic (%)	292,541	288,759	16.27%	0.00%	0.18%	0.70%	4.93%	99.99%
	Asian (%)	292,541	288,759	3.61%	0.00%	0.04%	0.15%	0.71%	99.97%
	Non-Hispanic White (%)	292,541	288,759	64.46%	0.00%	26.31%	83.97%	96.71%	100.00%
	Contract Amount (\$)	418,409	418,409	19,622	1,483	14,407	18,420	23,700	162,346
	Term (Months)	418,409	418,409	67	12	60	72	72	84
	Credit Score								

< 680	Buy Rate	418.409	418.409	8.10	0.90	5.68	7.69	9.80	24.99
	Contract Rate	418.409	418.409	9.51	0.90	7.05	8.99	11.35	25.99
	Dealer Reserve (BPS)	418.409	418.409	141	0	100	150	200	295
	Dealer Reserve (\$)	418.409	418.409	906	0	483	896	1,290	13,015
	LTV (%)	418.409	385.139	112.78	1.47	101.52	115.81	127.00	216.10
	PTI (%)	418.409	398.430	8.73	0.11	5.49	8.07	11.33	99.02
	African American (%)	418.409	412.961	16.25%	0.00%	0.16%	1.88%	18.39%	100.00%
	Hispanic (%)	418.409	412.961	16.52%	0.00%	0.18%	0.69%	4.96%	100.00%
	Asian (%)	418.409	412.961	2.78%	0.00%	0.03%	0.14%	0.60%	99.97%
	Non-Hispanic White (%)	418.409	412.961	62.29%	0.00%	20.73%	60.70%	96.31%	100.00%
	Contract Amount (\$)	423.678	423.678	18,704	1,100	14,193	17,661	22,215	149,602
	Term (Months)	423.678	423.678	67	12	60	72	72	75
	Buy Rate	423.678	423.678	11.35	0.90	8.49	10.99	13.95	26.46
	Contract Rate	423.678	423.678	12.80	0.90	9.92	12.50	15.50	27.00
600 ≤ Credit Score < 640	Dealer Reserve (BPS)	423.678	423.678	145	0	100	152	200	300
	Dealer Reserve (\$)	423.678	423.678	931	0	509	929	1,328	8,898
	LTV (%)	423.678	401.353	113.28	8.63	103.00	116.00	125.42	206.83
	PTI (%)	423.678	405.268	9.91	0.18	6.49	9.34	12.71	99.36
	African American (%)	423.678	414.907	19.21%	0.00%	0.19%	2.69%	26.03%	100.00%
	Hispanic (%)	423.678	414.907	16.06%	0.00%	0.18%	0.70%	4.72%	100.00%
	Asian (%)	423.678	414.907	2.37%	0.00%	0.03%	0.13%	0.57%	99.97%
	Non-Hispanic White (%)	423.678	414.907	60.09%	0.00%	17.04%	76.46%	95.64%	100.00%
	Contract Amount (\$)	641.148	641.148	17,753	1,107	13,836	16,930	20,851	103,021
	Term (Months)	641.148	641.148	67	12	60	72	72	84
	Buy Rate	641.148	641.148	14.95	1.79	11.90	14.93	17.99	34.79
	Contract Rate	641.148	641.148	16.29	1.79	13.39	16.32	18.95	34.79
	Dealer Reserve (BPS)	641.148	641.148	134	0	100	150	200	297
	Dealer Reserve (\$)	641.148	641.148	134	0	100	150	200	297

	Dealer Reserve (\$)	641,148	641,148	862	0	377	825	1,289	7,444
	LTV (%)	641,148	627,533	112.33	3.36	103.00	115.00	124.00	240.00
	PTI (%)	641,148	623,108	10.73	0.17	7.33	10.20	13.37	98.42
	African American (%)	641,148	626,700	21.41%	0.00%	0.23%	3.55%	32.64%	100.00%
	Hispanic (%)	641,148	626,700	15.13%	0.00%	0.19%	0.71%	4.24%	99.99%
	Asian (%)	641,148	626,700	1.99%	0.00%	0.04%	0.14%	0.56%	99.97%
	Non-Hispanic White (%)	641,148	626,700	59.06%	0.00%	16.39%	74.01%	95.17%	100.00%
	Contract Amount (\$)	15,893	15,893	15,336	1,064	10,946	14,690	18,577	225,576
	Term (Months)	15,893	15,893	59	12	60	60	72	75
	Buy Rate	15,893	15,893	8.32	1.49	5.19	8.34	10.04	37.79
Unknown / Invalid Credit Score	Contract Rate	15,893	15,893	9.80	1.49	6.84	9.84	11.95	37.79
	Dealer Reserve (BPS)	15,893	15,893	148	0	100	188	220	289
	Dealer Reserve (\$)	15,893	15,893	677	0	256	668	1,026	4,094
	LTV (%)	15,893	9,386	84.86	8.28	68.49	89.00	100.00	180.02
	PTI (%)	15,893	12,237	9.93	0.41	6.44	9.37	12.79	71.11
	African American (%)	15,893	15,862	13.57%	0.00%	0.15%	1.45%	12.63%	99.95%
	Hispanic (%)	15,893	15,862	18.66%	0.00%	0.22%	1.08%	9.44%	99.99%
	Asian (%)	15,893	15,862	6.13%	0.00%	0.05%	0.23%	1.60%	99.89%
	Non-Hispanic White (%)	15,893	15,862	59.63%	0.00%	13.92%	76.67%	95.46%	99.99%

17. APPENDIX J. DEALER RESERVE REGRESSION RESULTS

Level of Dealer Reserve as Measured in BPS						
All Non-Subvented Contracts						
Model	Minority Group	Proxied Count	Average BISG %	Coeff.	P-Value	Adjusted R-Squared
No Controls	African American	5,579,687	13.66%	16.93	0.00	0.0034
	Hispanic	5,579,687	13.86%	9.38	0.00	0.0034
	Asian	5,579,687	3.58%	13.40	0.00	0.0034
Broad Credit Tranche	African American	5,579,687	13.66%	5.42	0.00	0.0273
	Hispanic	5,579,687	13.86%	1.76	0.00	0.0273
	Asian	5,579,687	3.58%	13.97	0.00	0.0273
Narrow Credit Tranche	African American	5,579,687	13.66%	4.45	0.00	0.0313
	Hispanic	5,579,687	13.86%	1.37	0.00	0.0313
	Asian	5,579,687	3.58%	14.49	0.00	0.0313
State	African American	5,579,687	13.66%	20.91	0.00	0.0164
	Hispanic	5,579,687	13.86%	12.58	0.00	0.0164
	Asian	5,579,687	3.58%	15.16	0.00	0.0164
MSA	African American	5,579,687	13.66%	19.78	0.00	0.0258
	Hispanic	5,579,687	13.86%	13.13	0.00	0.0258
	Asian	5,579,687	3.58%	9.92	0.00	0.0258
LMI Categories	African American	5,579,687	13.66%	12.81	0.00	0.0045
	Hispanic	5,579,687	13.86%	7.05	0.00	0.0045
	Asian	5,579,687	3.58%	13.03	0.00	0.0045
Broad Credit Tranche + MSA	African American	5,579,687	13.66%	7.82	0.00	0.0483
	Hispanic	5,579,687	13.86%	5.57	0.00	0.0483
	Asian	5,579,687	3.58%	10.12	0.00	0.0483
Broad Credit Tranche + MSA + New/Used + Term	African American	5,579,687	13.66%	7.94	0.00	0.0574
	Hispanic	5,579,687	13.86%	6.16	0.00	0.0574
	Asian	5,579,687	3.58%	9.23	0.00	0.0574

Source: CRA Contract Data

Level of Dealer Reserve as Measured in Basis Points Excluding Contracts with no Dealer Reserve						
Model	Minority Group	Proxied Count	Average BISG %	Coef.	P-Value	Adjusted R- Squared
No Controls	African American	4,286,984	14.13%	7.86	0.00	0.0023
	Hispanic	4,286,984	14.04%	6.25	0.00	0.0023
	Asian	4,286,984	3.63%	11.56	0.00	0.0023
Broad Credit Tranche	African American	4,286,984	14.13%	3.03	0.00	0.0123
	Hispanic	4,286,984	14.04%	3.37	0.00	0.0123
	Asian	4,286,984	3.63%	12.01	0.00	0.0123
Narrow Credit Tranche	African American	4,286,984	14.13%	2.52	0.00	0.0160
	Hispanic	4,286,984	14.04%	3.25	0.00	0.0160
	Asian	4,286,984	3.63%	12.48	0.00	0.0160
State	African American	4,286,984	14.13%	9.47	0.00	0.0101
	Hispanic	4,286,984	14.04%	7.36	0.00	0.0101
	Asian	4,286,984	3.63%	12.39	0.00	0.0101
MSA	African American	4,286,984	14.13%	8.38	0.00	0.0171
	Hispanic	4,286,984	14.04%	7.57	0.00	0.0171
	Asian	4,286,984	3.63%	9.95	0.00	0.0171
LMI Categories	African American	4,286,984	14.13%	5.92	0.00	0.0027
	Hispanic	4,286,984	14.04%	5.13	0.00	0.0027
	Asian	4,286,984	3.63%	11.33	0.00	0.0027
Broad Credit Tranche + MSA	African American	4,286,984	14.13%	3.16	0.00	0.0271
	Hispanic	4,286,984	14.04%	4.52	0.00	0.0271
	Asian	4,286,984	3.63%	9.29	0.00	0.0271
Broad Credit Tranche + MSA + New/Used + Term	African American	4,286,984	14.13%	5.18	0.00	0.0636
	Hispanic	4,286,984	14.04%	6.36	0.00	0.0636
	Asian	4,286,984	3.63%	5.52	0.00	0.0636

Source: CRA Contract Data

Source: CRA Contract Data

Dealer Reserve Base Model Output (BPS)									
Control	Comparison Group	All			Non-Hispanic White				
		Coeff.	T-Stat	P-Value	Coeff.	T-Stat	P-Value		
720 ≤ Credit Score < 760	Credit Score ≥ 760	7.1	56.63	0.00	5.3	34.40	0.00		
620 ≤ Credit Score < 720		25.8	293.02	0.00	22.5	202.12	0.00		
Credit Score < 620		33.1	334.33	0.00	35.7	270.24	0.00		
Unknown Credit Score		29.1	68.76	0.00	21.9	36.96	0.00		
Constant		101.0	1478.42	0.00	101.1	1260.14	0.00		
Adjusted R-Squared				0.05				0.05	
Number of Contracts				5,579,687				3,201,529	
Control	Comparison Group	African American			Hispanic				
		Coeff.	T-Stat	P-Value	Coeff.	T-Stat	P-Value		
720 ≤ Credit Score < 760	Credit Score ≥ 760	11.2	14.14	0.00	9.7	22.91	0.00		
620 ≤ Credit Score < 720		29.2	51.52	0.00	27.0	83.80	0.00		
Credit Score < 620		21.7	37.95	0.00	27.5	78.78	0.00		
Unknown Credit Score		36.3	18.99	0.00	46.7	39.89	0.00		
Constant		110.7	210.84	0.00	101.1	353.59	0.00		
Adjusted R-Squared				0.03				0.05	
Number of Contracts				284,925				624,256	
Control	Comparison Group	Asian							
		Coeff.	T-Stat	P-Value					
720 ≤ Credit Score < 760	Credit Score ≥ 760	9.4	11.91	0.00					
620 ≤ Credit Score < 720		24.5	38.31	0.00					
Credit Score < 620		34.3	38.90	0.00					
Unknown Credit Score		26.6	15.24	0.00					
Constant		111.9	241.16	0.00					
Adjusted R-Squared				0.04					
Number of Contracts				112,374					

Note: The model also controls for the MSA or state when not in an MSA.

Dealer Reserve Full Model Output (BPS)									
Control	Comparison Group	All			Non-Hispanic White				
		Coef.	T-Stat	P-Value	Coef.	T-Stat	P-Value		
720 ≤ Credit Score < 760	Credit Score ≥ 760	7.7	61.09	0.00	5.9	37.61	0.00		
620 ≤ Credit Score < 720		25.9	275.89	0.00	22.5	189.41	0.00		
Credit Score < 620		30.7	287.19	0.00	33.5	234.42	0.00		
Unknown Credit Score	Used	27.1	64.25	0.00	20.2	34.23	0.00		
New		-13.1	-177.49	0.00	-11.7	-118.30	0.00		
Term ≤ 60 Months		10.0	122.80	0.00	9.1	87.14	0.00		
Constant	Term > 60 Months	105.6	1070.15	0.00	105.0	847.61	0.00		
Adjusted R-Squared		5.579,687			3.201,529				
Number of Contracts									
Control	Comparison Group	African American			Hispanic				
		Coef.	T-Stat	P-Value	Coef.	T-Stat	P-Value		
720 ≤ Credit Score < 760	Credit Score ≥ 760	12.1	15.32	0.00	10.8	25.54	0.00		
620 ≤ Credit Score < 720		29.6	51.57	0.00	27.1	83.61	0.00		
Credit Score < 620		20.3	34.84	0.00	24.7	69.54	0.00		
Unknown Credit Score	Used	34.4	18.16	0.00	41.6	35.89	0.00		
New		-10.8	-35.47	0.00	-15.8	-71.70	0.00		
Term ≤ 60 Months		12.0	28.69	0.00	15.0	54.62	0.00		
Constant	Term > 60 Months	113.3	196.50	0.00	106.9	315.25	0.00		
Adjusted R-Squared		284,925			624,256				
Number of Contracts									
Control	Comparison Group	Asian							
		Coef.	T-Stat	P-Value					
720 ≤ Credit Score < 760	Credit Score ≥ 760	9.1	11.47	0.00					
620 ≤ Credit Score < 720		23.7	35.79	0.00					
Credit Score < 620		32.0	34.53	0.00					
Unknown Credit Score	Used	26.2	15.08	0.00					
New		-15.6	-26.21	0.00					
Term ≤ 60 Months		6.2	11.42	0.00					
Constant	Term > 60 Months	120.1	154.57	0.00					
Adjusted R-Squared		112,374							
Number of Contracts									

Note: The model also controls for MSA or state when not in an MSA.

18. APPENDIX K. COST/BENEFIT SCENARIO RESULTS

Summary of Effect of Changing to Flat Rates by Race and Ethnicity Scenario 1 - Spread Dealer Reserve Across All Buy Rates by New/Used and Finance Company									
Group	Count of Group Contracts	% Down	% Up	Avg Chg in Rate (bps)	Avg Chg in \$ ¹ Paid ¹	Among those Lowered		Among those Raised	
						Avg Chg in Rate (bps)	Avg Chg in \$ ¹ Paid ¹	Avg Chg in Rate (bps)	Avg Chg in \$ ¹ Paid ¹
All Contracts									
All	5,651,064	55.0	45.0	0.5	\$0	-66.0	-\$476	81.8	\$581
AA	762,257	57.9	42.1	-3.5	-\$32	-64.3	-\$494	80.2	\$606
Hispanic	773,185	57.4	42.6	-2.6	-\$12	-66.5	-\$510	83.5	\$658
Asian	199,724	56.9	43.1	-6.5	-\$44	-74.5	-\$492	83.3	\$548
NHW	3,726,370	53.7	46.3	2.5	\$12	-65.7	-\$462	81.7	\$563
Contracts with a Dealer Reserve									
All	4,342,994	71.5	28.5	-34.7	-\$244	-66.0	-\$476	44.1	\$339
AA	605,980	72.9	27.1	-35.2	-\$267	-64.3	-\$494	43.2	\$343
Hispanic	602,088	73.7	26.3	-37.0	-\$278	-66.5	-\$510	45.8	\$373
Asian	155,729	73.0	27.0	-41.5	-\$270	-74.5	-\$492	47.6	\$331
NHW	2,830,657	70.7	29.3	-33.6	-\$229	-65.7	-\$462	43.8	\$334
Contracts without a Dealer Reserve									
All	1,308,070	0.0	100	117.3	\$810			117.3	\$810
AA	156,278	0.0	100	119.2	\$882			119.2	\$882
Hispanic	171,097	0.0	100	118.4	\$923			118.4	\$923
Asian	43,995	0.0	100	117.4	\$756			117.4	\$756
NHW	895,713	0.0	100	116.6	\$776			116.6	\$776
Source: CRA Contract Data									
¹ Assumes no contracts prepay									

November 19, 2014

American Financial Services Association

Summary of Effect of Changing to Flat Rates by Tier Scenario 1 - Spread Dealer Reserve Across All Buy Rates by New/Used and Finance Company									
Credit Tier	Count of Group Contracts	% Down	% Up	Avg Chg in Rate (bps)	Avg Chg in \$\$ Paid ¹	Among those Lowered		Among those Raised	
						Avg Chg in Rate (bps)	Avg Chg in \$\$ Paid ¹	Avg Chg in Rate (bps)	Avg Chg in \$\$ Paid ¹
All Contracts									
All	5,651,064	55.0	45.0	0.5	\$0	-66.0	-\$476	81.8	\$581
CS ≥ 760	1,659,057	44.6	55.4	15.4	\$88	-71.0	-\$450	84.9	\$520
720 ≤ CS < 760	654,932	49.8	50.2	8.3	\$64	-66.5	-\$484	82.6	\$608
680 ≤ CS < 720	736,161	57.1	42.9	-1.9	-\$6	-63.5	-\$489	80.1	\$639
640 ≤ CS < 680	854,367	65.0	35.0	-13.5	-\$95	-62.8	-\$491	78.3	\$642
600 ≤ CS < 640	734,380	66.1	33.9	-15.9	-\$112	-64.8	-\$489	79.4	\$624
CS < 600	963,919	57.1	42.9	-2.8	-\$16	-64.3	-\$469	78.9	\$587
Missing or Invalid CS	48,248	61.4	38.6	-16.3	-\$99	-83.1	-\$445	89.8	\$449
Contracts with a Dealer Reserve									
All	4,342,994	71.5	28.5	-34.7	-\$244	-66.0	-\$476	44.1	\$339
CS ≥ 760	1,140,942	64.8	35.2	-29.9	-\$181	-71.0	-\$450	45.7	\$315
720 ≤ CS < 760	478,568	68.2	31.8	-31.2	-\$215	-66.5	-\$484	44.7	\$363
680 ≤ CS < 720	573,485	73.3	26.7	-35.0	-\$259	-63.5	-\$489	43.5	\$375
640 ≤ CS < 680	704,298	78.9	21.1	-40.9	-\$312	-62.8	-\$491	40.7	\$357
600 ≤ CS < 640	614,560	79.0	21.0	-42.4	-\$315	-64.8	-\$489	41.5	\$338
CS < 600	794,731	69.2	30.8	-30.7	-\$222	-64.3	-\$469	44.8	\$334
Missing or Invalid CS	36,410	81.3	18.7	-58.6	-\$312	-83.1	-\$445	47.7	\$269
Contracts without a Dealer Reserve									
All	1,308,070	0.0	100.0	117.3	\$810			117.3	\$810
CS ≥ 760	518,115	0.0	100.0	115.3	\$679			115.3	\$679
720 ≤ CS < 760	176,364	0.0	100.0	115.2	\$820			115.2	\$820
680 ≤ CS < 720	162,676	0.0	100.0	114.5	\$887			114.5	\$887
640 ≤ CS < 680	150,069	0.0	100.0	115.4	\$925			115.4	\$925
600 ≤ CS < 640	119,820	0.0	100.0	120.2	\$932			120.2	\$932
CS < 600	169,188	0.0	100.0	128.3	\$954			128.3	\$954
Missing or Invalid CS	11,838	0.0	100.0	114.0	\$553			114.0	\$553
Source: CRA Contract Data									
¹ Assumes no contracts prepay									

November 19, 2014

American Financial Services Association

Summary of Effect of Changing to Flat Rates by Race and Ethnicity Scenario 2 - Spread Dealer Reserve Across All Buy Rates by New/Used, Credit Tranche, and Finance Company									
Group	Count of Group Contracts	% Down	% Up	Avg Chg in Rate (bps)	Avg Chg in \$\$ Paid ¹	Among those Lowered		Among those Raised	
						Avg Chg in Rate (bps)	Avg Chg in \$\$ Paid ¹	Avg Chg in Rate (bps)	Avg Chg in \$\$ Paid ¹
All Contracts									
All	5,651,064	55.9	44.1	-0.4	\$0	-64.0	-\$456	80.1	\$576
AA	762,257	58.1	41.9	-1.9	-\$13	-60.7	-\$461	79.8	\$610
Hispanic	773,185	57.4	42.6	-0.5	\$9	-62.8	-\$478	83.5	\$664
Asian	199,724	57.9	42.1	-8.7	-\$50	-73.5	-\$478	80.4	\$536
NHW	3,726,370	54.9	45.1	0.5	\$4	-64.3	-\$448	79.5	\$555
Contracts with a Dealer Reserve									
All	4,342,994	72.7	27.3	-34.6	-\$238	-64.0	-\$456	43.6	\$342
AA	605,980	73.1	26.9	-32.7	-\$243	-60.7	-\$461	43.4	\$351
Hispanic	602,088	73.7	26.3	-34.2	-\$252	-62.8	-\$478	46.1	\$381
Asian	155,729	74.2	25.8	-42.8	-\$271	-73.5	-\$478	45.5	\$324
NHW	2,830,657	72.3	27.7	-34.6	-\$231	-64.3	-\$448	43.1	\$334
Contracts without a Dealer Reserve									
All	1,308,070	0.0	100.0	113.3	\$789			113.3	\$789
AA	156,278	0.0	100.0	117.7	\$879			117.7	\$879
Hispanic	171,097	0.0	100.0	118.1	\$926			118.1	\$926
Asian	43,995	0.0	100.0	112.2	\$730			112.2	\$730
NHW	895,713	0.0	100.0	111.4	\$748			111.4	\$748
Source: CRA Contract Data									
¹ Assumes no contracts prepay									

November 19, 2014

American Financial Services Association

Summary of Effect of Changing to Flat Rates by Tier Scenario 2 - Spread Dealer Reserve Across All Buy Rates by New/Used, Credit Tranche, and Finance Company									
Credit Tier	Count of Group Con- tracts	% Dow n	% Up	Avg Chg in Rate (bps)	Avg Chg in \$\$ Paid ¹	Among those Lowered		Among those Raised	
						Avg Chg in Rate (bps)	Avg Chg in \$\$ Paid ¹	Avg Chg in Rate (bps)	Avg Chg in \$\$ Paid
All Contracts									
All	5,651,064	55.9	44.1	-0.4	\$0	-64.0	-\$456	80.1	\$576
CS ≥ 760	1,659,057	49.3	50.7	1.8	\$0	-76.5	-\$487	77.9	\$473
720 ≤ CS < 760	654,932	51.9	48.1	0.0	\$0	-71.8	-\$526	77.3	\$567
680 ≤ CS < 720	736,161	56.8	43.2	-0.8	\$0	-62.2	-\$483	80.1	\$636
640 ≤ CS < 680	854,367	62.8	37.2	-1.6	\$0	-52.6	-\$411	84.5	\$694
600 ≤ CS < 640	734,380	64.0	36.0	-2.0	\$0	-52.7	-\$392	88.3	\$698
CS < 600	963,919	56.6	43.4	-1.8	\$0	-62.5	-\$448	77.2	\$584
Missing or Invalid CS	48,248	59.4	40.6	2.1	\$0	-66.5	-\$353	102.4	\$517
Contracts with a Dealer Reserve									
All	4,342,994	72.7	27.3	-34.6	-\$238	-64.0	-\$456	43.6	\$342
CS ≥ 760	1,140,942	71.7	28.3	-43.0	-\$267	-76.5	-\$487	41.7	\$290
720 ≤ CS < 760	478,568	71.0	29.0	-39.3	-\$278	-71.8	-\$526	40.3	\$327
680 ≤ CS < 720	573,485	72.9	27.1	-33.7	-\$253	-62.2	-\$483	43.1	\$368
640 ≤ CS < 680	704,298	76.2	23.8	-29.1	-\$217	-52.6	-\$411	46.3	\$402
600 ≤ CS < 640	614,560	76.5	23.5	-28.7	-\$205	-52.7	-\$392	49.7	\$406
CS < 600	794,731	68.6	31.4	-29.6	-\$206	-62.5	-\$448	42.3	\$324
Missing or Invalid CS	36,410	78.7	21.3	-39.9	-\$208	-66.5	-\$353	58.3	\$330
Contracts without a Dealer Reserve									
All	1,308,070	0.0	100	113.3	\$789			113.3	\$789
CS ≥ 760	518,115	0.0	100	100.5	\$587			100.5	\$587
720 ≤ CS < 760	176,364	0.0	100	106.6	\$755			106.6	\$755
680 ≤ CS < 720	162,676	0.0	100	115.3	\$891			115.3	\$891
640 ≤ CS < 680	150,069	0.0	100	127.2	\$1,020			127.2	\$1,020
600 ≤ CS < 640	119,820	0.0	100	134.7	\$1,050			134.7	\$1,050
CS < 600	169,188	0.0	100	128.8	\$966			128.8	\$966
Missing or Invalid CS	11,838	0.0	100	131.3	\$639			131.3	\$639
Source: CRA Contract Data ¹ Assumes no contracts prepay									



November 19, 2014

American Financial Services Association

Summary of Effect of Changing to Flat Rates by Race and Ethnicity Scenario 3 - Spread Dealer Reserve Across Buy Rates with Dealer Reserves by New/Used and Finance Company									
Group	Count of Group Contracts	% Down	% Up	Avg Chg in Rate (bps)	Avg Chg in \$\$ Paid ¹	Among those Lowered		Among those Raised	
						Avg Chg in Rate (bps)	Avg Chg in \$\$ Paid ¹	Avg Chg in Rate (bps)	Avg Chg in \$\$ Paid ¹
All Contracts									
All	5,651,064	47.5	29.4	-1.9	\$0	-41.7	-\$291	60.8	\$470
AA	762,257	51.4	28.1	-2.8	-\$11	-38.8	-\$290	61.2	\$490
Hispanic	773,185	50.8	27.0	-3.4	-\$13	-40.1	-\$300	63.0	\$517
Asian	199,724	49.0	29.0	-4.8	-\$20	-48.1	-\$308	64.7	\$454
NHW	3,726,370	45.8	30.2	-1.3	\$6	-42.4	-\$289	60.0	\$459
Contracts with a Dealer Reserve									
All	4,342,994	61.8	38.2	-2.5	\$0	-41.7	-\$291	60.8	\$470
AA	605,980	64.7	35.3	-3.5	-\$14	-38.8	-\$290	61.2	\$490
Hispanic	602,088	65.3	34.7	-4.3	-\$17	-40.1	-\$300	63.0	\$517
Asian	155,729	62.9	37.1	-6.2	-\$25	-48.1	-\$308	64.7	\$454
NHW	2,830,657	60.3	39.7	-1.7	\$8	-42.4	-\$289	60.0	\$459
Contracts without a Dealer Reserve									
All	1,308,070	0.0	0.0	0.0	\$0	.	.	.	.
AA	156,278	0.0	0.0	0.0	\$0	.	.	.	.
Hispanic	171,097	0.0	0.0	0.0	\$0	.	.	.	.
Asian	43,995	0.0	0.0	0.0	\$0	.	.	.	.
NHW	895,713	0.0	0.0	0.0	\$0	.	.	.	.
Source: CRA Contract Data									
¹ Assumes no contracts prepay									

November 19, 2014

American Financial Services Association

Summary of Effect of Changing to Flat Rates by Tier Scenario 3 - Spread Dealer Reserve Across Buy Rates with Dealer Reserves by New/Used, and Finance Company									
Credit Tier	Count of Group Contracts	% Down	% Up	Avg Chg in Rate (bps)	Avg Chg in \$\$ Paid ¹	Among those Lowered		Among those Raised	
						Avg Chg in Rate (bps)	Avg Chg in \$\$ Paid ¹	Avg Chg in Rate (bps)	Avg Chg in \$\$ Paid ¹
All Contracts									
All	5,651,064	47.5	29.4	-1.9	\$0	-41.7	-\$291	60.8	\$470
CS ≥ 760	1,659,057	34.9	33.9	3.2	\$36	-50.8	-\$311	61.9	\$428
720 ≤ CS < 760	654,932	40.5	32.6	2.0	\$36	-43.9	-\$308	60.5	\$492
680 ≤ CS < 720	736,161	48.5	29.4	-1.9	\$7	-39.3	-\$293	58.2	\$506
640 ≤ CS < 680	854,367	57.9	24.6	-7.9	-\$43	-37.0	-\$282	55.1	\$487
600 ≤ CS < 640	734,380	60.7	23.0	-9.5	-\$58	-37.9	-\$278	58.9	\$483
CS < 600	963,919	53.3	29.2	-1.7	-\$6	-39.4	-\$281	66.0	\$494
Missing or Invalid CS	48,248	56.6	18.8	-16.7	-\$79	-51.9	-\$269	67.2	\$386
Contracts with a Dealer Reserve									
All	4,342,994	61.8	38.2	-2.5	\$0	-41.7	-\$291	60.8	\$470
CS ≥ 760	1,140,942	50.8	49.2	4.7	\$53	-50.8	-\$311	61.9	\$428
720 ≤ CS < 760	478,568	55.4	44.6	2.7	\$49	-43.9	-\$308	60.5	\$492
680 ≤ CS < 720	573,485	62.2	37.8	-2.4	\$9	-39.3	-\$293	58.2	\$506
640 ≤ CS < 680	704,298	70.2	29.8	-9.6	-\$53	-37.0	-\$282	55.1	\$487
600 ≤ CS < 640	614,560	72.5	27.5	-11.3	-\$69	-37.9	-\$278	58.9	\$483
CS < 600	794,731	64.6	35.4	-2.1	-\$7	-39.4	-\$281	66.0	\$494
Missing or Invalid CS	36,410	75.0	25.0	-22.2	\$105	-51.9	-\$269	67.2	\$386
Contracts without a Dealer Reserve									
All	1,308,070	0.0	0.0	0.0	\$0				
CS ≥ 760	518,115	0.0	0.0	0.0	\$0				
720 ≤ CS < 760	176,364	0.0	0.0	0.0	\$0				
680 ≤ CS < 720	162,676	0.0	0.0	0.0	\$0				
640 ≤ CS < 680	150,069	0.0	0.0	0.0	\$0				
600 ≤ CS < 640	119,820	0.0	0.0	0.0	\$0				
CS < 600	169,188	0.0	0.0	0.0	\$0				
Missing or Invalid CS	11,838	0.0	0.0	0.0	\$0				
Source: CRA Contract Data ¹ Assumes no contracts prepay									

November 19, 2014

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Summary of Effect of Changing to Flat Rates by Race and Ethnicity Scenario 4 - Spread Dealer Reserve Across Buy Rates with Dealer Reserves by New/Used, Credit Tier, and Finance Company									
Group	Count of Group Contracts	% Down	% Up	Avg Chg in Rate (bps)	Avg Chg in \$\$ Paid ¹	Among those Lowered		Among those Raised	
						Avg Chg in Rate (bps)	Avg Chg in \$\$ Paid ¹	Avg Chg in Rate (bps)	Avg Chg in \$\$ Paid ¹
All Contracts									
All	5,651,064	48.5	28.3	-2.2	\$0	-40.0	-\$276	60.7	\$474
AA	762,257	51.9	27.6	-1.9	-\$2	-36.3	-\$268	61.2	\$495
Hispanic	773,185	51.3	26.5	-2.4	-\$3	-37.4	-\$277	63.5	\$524
Asian	199,724	50.7	27.3	-6.1	-\$24	-46.7	-\$294	64.4	\$457
NHW	3,726,370	47.1	28.9	-2.0	\$3	-41.1	-\$277	59.9	\$461
Contracts with a Dealer Reserve									
All	4,342,994	63.1	36.9	-2.9	\$0	-40.0	-\$276	60.7	\$474
AA	605,980	65.3	34.7	-2.4	-\$3	-36.3	-\$268	61.2	\$495
Hispanic	602,088	65.9	34.1	-3.0	-\$4	-37.4	-\$277	63.5	\$524
Asian	155,729	65.0	35.0	-7.8	-\$31	-46.7	-\$294	64.4	\$457
NHW	2,830,657	62.0	38.0	-2.7	\$3	-41.1	-\$277	59.9	\$461
Contracts without a Dealer Reserve									
All	1,308,070	0.0	0.0	0.0	\$0				
AA	156,278	0.0	0.0	0.0	\$0				
Hispanic	171,097	0.0	0.0	0.0	\$0				
Asian	43,995	0.0	0.0	0.0	\$0				
NHW	895,713	0.0	0.0	0.0	\$0				
Source: CRA Contract Data									
¹ Assumes no contracts prepay									

November 19, 2014

American Financial Services Association

Summary of Effect of Changing to Flat Rates by Tier Scenario 4 - Spread Dealer Reserve Across Buy Rates with Dealer Reserves by New/Used, Credit Tier, and Finance Company									
Credit Tier	Count of Group Contracts	% Down	% Up	Avg Chg in Rate (bps)	Avg Chg in \$\$ Paid ¹	Among those Lowered		Among those Raised	
						Avg Chg in Rate (bps)	Avg Chg in \$\$ Paid ¹	Avg Chg in Rate (bps)	Avg Chg in \$\$ Paid ¹
All Contracts									
All	5,651,064	48.5	28.3	-2.2	\$0	-40.0	-\$276	60.7	\$474
CS ≥ 760	1,659,057	38.5	30.3	-2.2	\$0	-53.1	-\$327	59.9	\$415
720 ≤ CS < 760	654,932	42.6	30.5	-2.4	\$0	-47.3	-\$338	58.3	\$472
680 ≤ CS < 720	736,161	49.5	28.4	-2.3	\$0	-38.5	-\$292	59.0	\$509
640 ≤ CS < 680	854,367	57.1	25.3	-2.5	\$0	-30.7	-\$231	59.3	\$522
600 ≤ CS < 640	734,380	59.7	24.0	-2.4	\$0	-30.0	-\$213	64.4	\$531
CS < 600	963,919	53.0	29.5	-1.6	\$0	-38.4	-\$269	63.7	\$483
Missing or Invalid CS	48,248	50.1	25.3	-2.9	\$0	-38.7	-\$192	65.0	\$379
Contracts with a Dealer Reserve									
All	4,342,994	63.1	36.9	-2.9	\$0	-40.0	-\$276	60.7	\$474
CS ≥ 760	1,140,942	55.9	44.1	-3.3	\$0	-53.1	-\$327	59.9	\$415
720 ≤ CS < 760	478,568	58.3	41.7	-3.3	\$0	-47.3	-\$338	58.3	\$472
680 ≤ CS < 720	573,485	63.6	36.4	-3.0	\$0	-38.5	-\$292	59.0	\$509
640 ≤ CS < 680	704,298	69.3	30.7	-3.1	\$0	-30.7	-\$231	59.3	\$522
600 ≤ CS < 640	614,560	71.3	28.7	-2.9	\$0	-30.0	-\$213	64.4	\$531
CS < 600	794,731	64.2	35.8	-1.9	\$0	-38.4	-\$269	63.7	\$483
Missing or Invalid CS	36,410	66.3	33.6	-3.8	\$0	-38.7	-\$192	65.0	\$379
Contracts without a Dealer Reserve									
All	1,308,070	0.0	0.0	0.0	\$0				
CS ≥ 760	518,115	0.0	0.0	0.0	\$0				
720 ≤ CS < 760	176,364	0.0	0.0	0.0	\$0				
680 ≤ CS < 720	162,676	0.0	0.0	0.0	\$0				
640 ≤ CS < 680	150,069	0.0	0.0	0.0	\$0				
600 ≤ CS < 640	119,820	0.0	0.0	0.0	\$0				
CS < 600	169,188	0.0	0.0	0.0	\$0				
Missing or Invalid CS	11,838	0.0	0.0	0.0	\$0				
Source: CRA Contract Data ¹ Assumes no contracts prepay									

19. APPENDIX L. CHARTS AND TABLESExecutive SummaryStudy

Table 1. 2013 Automotive Finance Market Shares

Table 2. Count of Financial Institutions for dealer assignment of contracts

Table 3. Population 18 and Tract 0050.02, Washington, DC

Table 4. Race/Ethnicity Probabilities for Surname "Johnson"

Table 5. National Household Vehicle Ownership by Race/Ethnicity

Table 6. Household Population Shares compared to financed vehicle purchase rates

Table 7. BISG Calculation Example

Table 8. Comparison of Proxy Approaches at identifying Race/Ethnicity

Table 9. Accuracy of Estimate using a Continuous BISG methodology

Table 10. Replica of CFPB White Paper Table #10

Table 11. Comparison of Estimated Raw APR Disparities using Actual vs Proxied Race / Ethnicity

Chart 1. New and Used Vehicle Sales by Year 1990-2013

Chart 2. Seasonality of New Vehicle Sales 2005-2009

Chart 3. Auto Finance Market Competitiveness

Chart 4. Auto ABS 1986-2013

Chart 5. Distribution of Census Bureau Surnames by Race/Ethnicity Probabilities

Chart 6. Count of African American Consumers Implied by BISG Continuous Methodology

Chart 7. Distribution of Dealer Reserve in CRA Contract Data

Chart 8. Steps for Analyzing Dealer Reserve Disparities

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Auto Insurance Affordability: Cost Drivers in Michigan



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Insurance Research Council
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Shannon O'Brien

Insurance Research Council Advisory Board, Chairperson

Contents

Executive Summary.....	1
Important Factors in the High Cost of Insurance in Michigan.....	1
Overview of Michigan's Auto Insurance System	2
Michigan Ranks Third Among Least-Affordable States	3
Accident Rates in Line With National Averages	4
High Average Loss Costs for PIP Claims in Michigan	5
BI Claim Frequency Rising and Pushing Up BI Loss Costs	6
Impact of Very Large PIP Claims	7
Expensive Medical Treatment in Michigan PIP Claims.....	8
Attorney Involvement and Litigation on the Rise	9
Cost Drivers in Detroit	10

Executive Summary

The affordability of auto insurance is an important public issue, as nearly every state requires drivers to purchase a minimum amount of insurance. The Insurance Research Council (IRC) continues to examine affordability issues with this profile of Michigan, the third-least-affordable state, where the affordability index (auto insurance expenditures as a percentage of median household income) was 2.21 percent from 2013 through 2016, compared with the national average of 1.58 percent.

For decades, policymakers in Michigan have debated the costs and benefits of the state's unique no-fault auto system, particularly the mandate that drivers purchase unlimited personal injury protection (PIP) coverage. The cost environment has deteriorated in recent years: from 2007 through 2015, Michigan moved up the ranking of states by average auto insurance expenditures (from eleventh to fourth). While debates continue in the state legislature, other solutions have been proposed. Some observers support a public referendum to spur change. (Similar referenda failed in 1992 and 1994.)¹ In Detroit, where costs are especially high, the mayor proposed creating a city-sponsored limited plan for residents and has since filed a lawsuit against the state over the lack of action on the issue.²

Policymakers across the country continue to debate the best approach to this issue. Regardless of whether the debate is about affordability at the national, state, or community level, any sustainable improvement will require an understanding of the factors that drive the cost of insurance.

Important Factors in the High Cost of Insurance in Michigan

- **Extremely high average claim severity**—With medical benefits being unlimited, the average amount paid for PIP claims in Michigan is dramatically higher than for countrywide PIP claims, driven by a small percentage of claims with extremely high claimed losses.
- **Unrestrained medical costs**—Because there is no ceiling on benefits and no fee schedule to control costs, the Michigan auto injury system creates opportunities for claim fraud and abuse and for the shifting of costs from other systems of paying for healthcare.
- **Increasing frequency of liability claims**—The rise in the frequency of bodily injury liability (BI) claims in Michigan indicates that the state's uniquely strict no-fault threshold has weakened.
- **Litigiousness**—The number of lawsuits filed for PIP claims has been growing rapidly in Michigan.
- **Influence of the Detroit area**—Surveys of auto insurance quotes often cite Detroit as the most expensive city for auto insurance. Similar to patterns seen in many other states, claims from accidents in Michigan's largest city are generally more likely to involve claiming behaviors associated with increased insurance costs, such as higher claimed losses, larger payments, and greater attorney involvement.

¹Fiona Kelliher and JC Reindl, "Dan Gilbert could fund auto insurance ballot measure," *Detroit Free Press*, November 19, 2018, <https://www.freep.com/story/news/local/michigan/2018/11/19/dan-gilbert-no-fault-ballot/2052823002/> (accessed March 27, 2019).

²Christine Ferretti, "Duggan, Metro drivers sue over no-fault insurance law," *The Detroit News*, August 23, 2018, <https://www.detroitnews.com/story/news/local/detroit-city/2018/08/23/duggan-drivers-sue-reforms-states-no-fault-law/1072008002/> (accessed March 27, 2019).

Overview of Michigan's Auto Insurance System

The Michigan auto insurance system is unique. Michigan drivers are required to purchase PIP coverage that provides unlimited lifetime medical benefits, reimbursement for up to three years of lost wages, and a daily allowance for replacement services for those injured while riding in a covered vehicle. After Michigan's unlimited coverage, the next-highest state-mandated PIP benefit is \$50,000 in New York. In addition to PIP coverage, drivers also must purchase BI liability insurance with minimum limits of \$20,000 per person and \$40,000 per accident.

The Michigan system is designed so that only those with serious injuries are eligible to file lawsuits or claims for general damages. The state's strict verbal threshold defines a serious injury as death, serious impairment of body function, or permanent serious disfigurement. The most commonly cited condition that overcame the tort threshold in 2012 was loss or impairment of a bodily function, present in 46 percent of BI claims in Michigan. In recent years, concerns have been raised about court decisions that have weakened the threshold by interpreting the definition of serious impairment to allow for "pain and suffering" claims by those with less-serious impairment.

In response to the unlimited benefits under Michigan's PIP system, the state established the Michigan Catastrophic Claims Association (MCCA) as a mechanism to spread the risk of catastrophic claims across the entire system. A per-vehicle charge is added to Michigan policies to allow the MCCA to provide payments for claims that meet certain severity thresholds. The annual assessment was \$192 per vehicle in 2018, increasing to \$220 in July 2019.

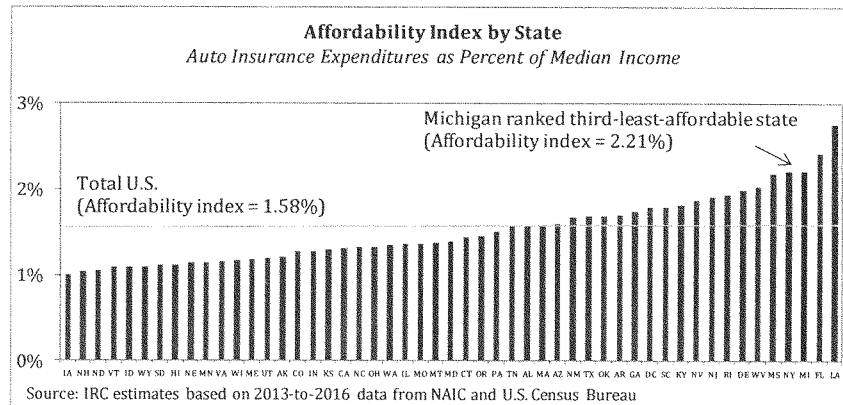
One unique PIP benefit in the state is attendant care. This benefit compensates professional caregivers or family members for time spent with very seriously injured persons who cannot be left alone, such as those with traumatic brain injuries. For the catastrophic claims covered by the MCCA, attendant care accounted for more than one-third of all expenses (18 percent for care provided by agencies and 18 percent for care provided by family members). In IRC's 2012-closed claim data, 9 percent of all Michigan PIP claims reported home healthcare expenses, compared with just 1 percent in other states. Critics of the current benefit structure cite attendant care as an easily abused benefit when provided by family members.

Michigan has one of the highest rates of uninsured motorists in the country, as measured by the ratio of uninsured motorist (UM) claim frequency to BI claim frequency. This ratio was 20 percent in 2015, compared with the countrywide ratio of 13 percent. Only three states (Florida, Mississippi, and New Mexico) had higher UM ratios in 2015. The Michigan Assigned Claims Plan provides PIP benefits to people injured in motor vehicle accidents when there is no automobile insurance available. In 2018, the total industry assessment to pay for this program was \$272 million, or \$37 per vehicle. The assessment grew 7 percent annualized from 2008 through 2018, significantly faster than the rate of inflation.

Until recently, Michigan was one of only 10 states without a state agency dedicated to fighting insurance fraud. In September 2018, the governor created a new division within the state's Department of Insurance and Financial Services (DIFS) to investigate acts of fraud in the insurance and financial sectors.³ However, because the fraud authority was created by executive order rather than by legislation, it has no funding mechanism.

³"Gov. Rick Snyder establishes anti-fraud unit within the Department of Insurance and Financial Services," MI Newswire, September 11, 2018, <https://www.michigan.gov/minewswire/0,4629,7-136-3452-477151-,00.html> (accessed April 3, 2019).

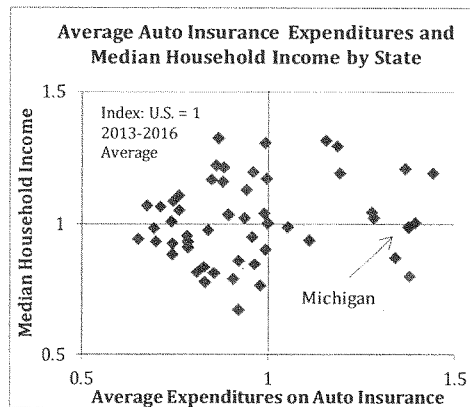
Michigan Ranks Third Among Least-Affordable States



As measured by the affordability index, Michigan is the third-least-affordable state for auto insurance, with an average index of 2.21 percent from 2013 through 2016. Countrywide, the index for that time frame was 1.60 percent.

Michigan's average auto insurance expenditure (total written premium for liability, collision, and comprehensive coverages divided by the liability exposures) was \$1,215 during that period, 38 percent higher than the U.S. average of \$882.⁴ Only three jurisdictions had higher expenditures (New Jersey, New York, and Louisiana). Moreover, average expenditures in Michigan grew 5 percent annualized from 2011 through 2016, faster than in any other state.

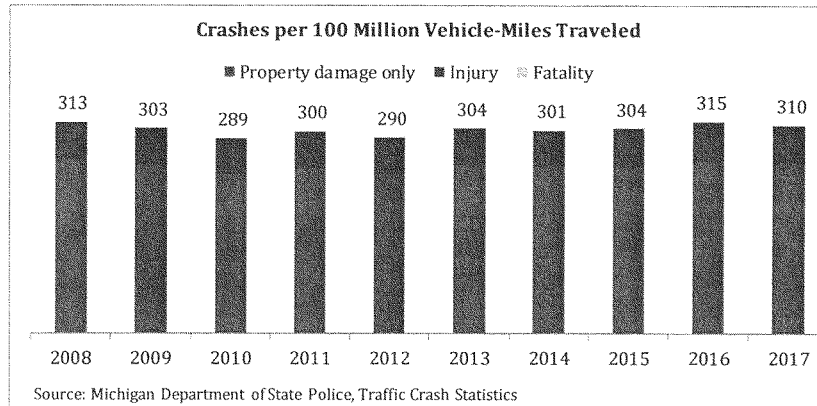
In 2017, the Federal Insurance Office (FIO) found that 72 percent of residents in Michigan's majority-minority or low- to moderate-income ZIP codes had an affordability index greater than 2 percent.⁵ Countrywide, the percentage of such residents with an index above 2 percent was much lower at 16 percent.



⁴"Auto Insurance Database Report 2014/2015," National Association of Insurance Commissioners, December 2017, www.naic.org/prod_serv/AUT-PB-14.pdf (accessed March 29, 2019).

⁵"Study on the Affordability of Personal Automobile Insurance," FIO, January 2017, pp.12-13, www.treasury.gov/initiatives/fio/reports-and-notice/Documents/FINAL%20Auto%20Affordability%20Study_web.pdf (accessed March 29, 2019).

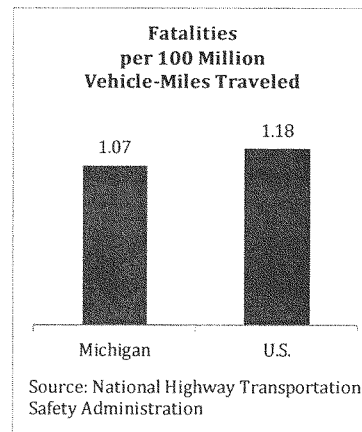
Accident Rates in Line With National Averages



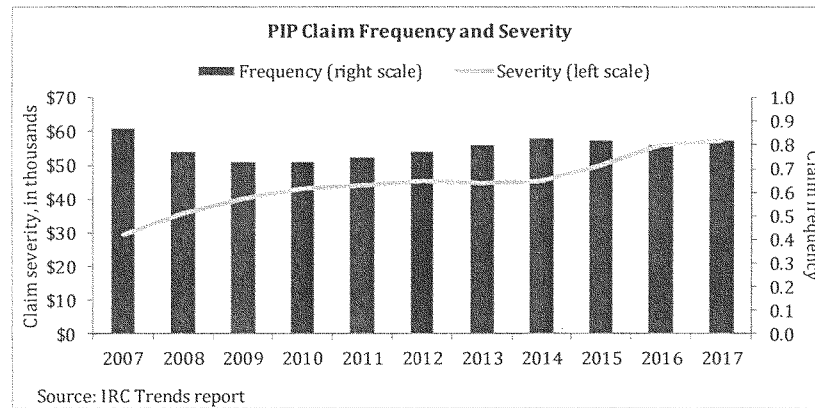
Unlike some other states with auto insurance affordability issues, Michigan's auto accident rates, and therefore its claim frequency rates, are below countrywide averages. According to government data, Michigan had a rate of motor vehicle fatalities in 2016 of 1.07 per 100 million vehicle-miles traveled, 10 percent lower than the 1.18 rate for the U.S. as a whole.

According to statistics from the Michigan State Police, the number of crashes in Michigan changed little from 2008 through 2017. When adjusted for the amount of vehicle-miles traveled in the state, the number of crashes fell slightly from 313 per 100 million vehicle-miles traveled in 2008 to 310 in 2017. The number of vehicle-miles and crashes can both be affected by economic conditions. The recession that began in 2007 hit Michigan especially hard, and the sluggishness of the recovery likely held down traffic statistics for several years.

In Michigan's unique environment, property damage claims are settled in a no-fault system. As a result, comparisons of the state's trends in property damage liability or collision claims cannot provide a meaningful look at differences in accident frequency.



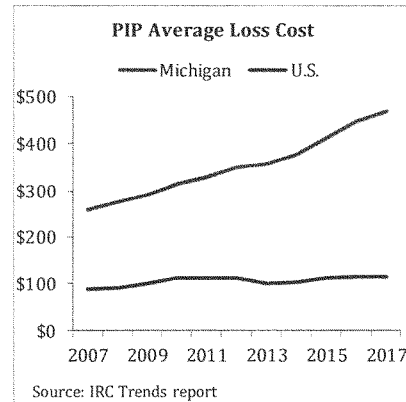
High Average Loss Costs for PIP Claims in Michigan



Consistent with lower-than-average crash rates, Michigan shows lower PIP claim frequency rates than the rest of the country: 0.82 claims per 100 earned vehicle-years in 2017, compared with 1.27 countrywide. From 2007 through 2017, PIP claim frequency declined 1 percent annualized, with a significant dip during the recession that was followed by slow growth.

The difference in frequency is eclipsed by the magnitude of PIP claim severity in a system with unlimited medical benefits. In 2017, the average PIP claim severity in Michigan was more than 6 times the countrywide level. Moreover, PIP claim severity increased nearly 7 percent annualized from 2007 through 2017, nearly double the countrywide rate.

Average loss cost is a function of how often claims are filed (claim frequency) and how large those claims are (claim severity). For Michigan PIP claims, it is vastly higher than the countrywide average. In 2017, the average payment per vehicle, including those not involved in accidents, was \$468 in Michigan, more than four times the countrywide average. Moreover, PIP average loss costs have increased 6 percent annualized from 2007 through 2017, compared with 3 percent annualized growth countrywide.

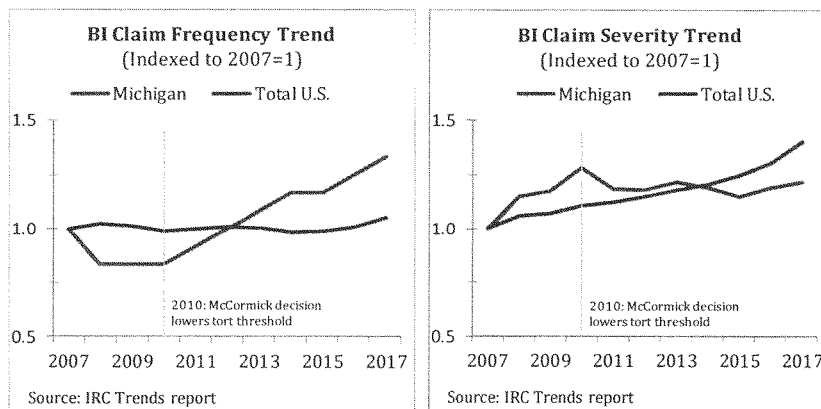


BI Claim Frequency Rising and Pushing Up BI Loss Costs

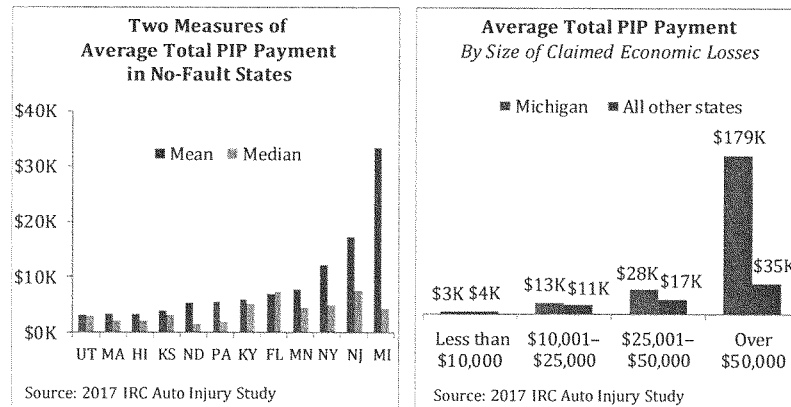
Michigan's no-fault law includes the strictest tort threshold in the country, designed to allow only seriously injured claimants to file BI liability claims and be eligible to receive "pain and suffering" awards. Because of this, Michigan's BI claim environment features very low claim frequency and very high claim severity. The combination results in average loss costs for BI claims that are considerably lower than the national average. In 2017, the BI average loss cost in Michigan was \$73 per insured vehicle, about half of the countrywide figure. However, from 2007 through 2017, annualized growth in the BI average loss cost in Michigan outpaced average growth in the U.S. (5 percent compared with 3 percent). Increased BI claim frequency is mostly to blame.

To facilitate comparisons between Michigan and countrywide trends over time, BI claim frequency and claim severity are indexed to equal 1 in 2007. In both Michigan and the U.S. as a whole, BI claim frequency rates are down significantly from their peaks in the mid-1990s, reflecting a long-term trend toward safer vehicles. However, the patterns have diverged in recent years. For the U.S. as a whole, BI claim frequency was relatively stable from 2007 through 2017. In Michigan, claim frequency dipped from 2007 to 2010 and then began to move sharply upward. From 2010 through 2017, claim frequency increased 7 percent annualized. BI claim severity followed the opposite pattern, increasing from 2007 to a peak in 2010 and then declining slightly. Countrywide, BI claim severity grew steadily over this period.

The increased frequency and decreased severity of BI liability claims suggests that Michigan's strict verbal threshold has loosened. In a 2010 decision, *McCormick v. Carrier*, the Michigan Supreme Court overturned a previous decision and in effect expanded the definition of "serious impairment of body function," the most commonly used criteria for overcoming the no-fault threshold that bars claimants without serious injuries from filing to receive pain and suffering awards.

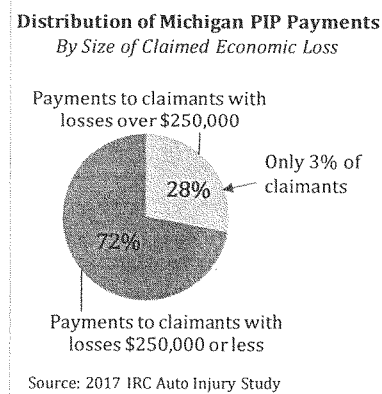


Impact of Very Large PIP Claims



Unlimited medical benefits and the subsequent large claims at the upper end of the payment distribution give Michigan the highest average payment for PIP claims among no-fault states. Among claims in IRC's 2017 closed-claim study, Michigan's mean amount paid for PIP claims was more than double that of the next highest no-fault state (New Jersey) and 10 times the mean payment in the lowest four states. Because the very large claims in Michigan skew the data, the comparison looks quite different using median analysis instead of mean. The median payment among 2017 PIP claims in Michigan was actually lower than the median in five other no-fault states and the median for all no-fault states combined.

Another way to look at the impact of large claims is to examine the average payment for different levels of claimed economic loss. Among claimants with less than \$10,000 in claimed medical expenses, lost wages, and other expenses, the average PIP payment in Michigan was actually lower than in other states. For claimants with losses between \$10,000 and \$50,000, the Michigan average was moderately higher. Among claimants with economic losses above \$50,000, the average PIP payment in Michigan was five times the payment in all other states (\$179,110 compared with \$35,000).



At the extreme end of the payment distribution, claimants with more than \$250,000 in claimed economic losses accounted for just 3 percent of Michigan PIP claimants in 2017. In other words, a no-fault system with limits of \$250,000 would have sufficiently covered 97 percent of claimants. In 2017, this top 3 percent of claimants accounted for 28 percent of total PIP payments.

Expensive Medical Treatment in Michigan PIP Claims

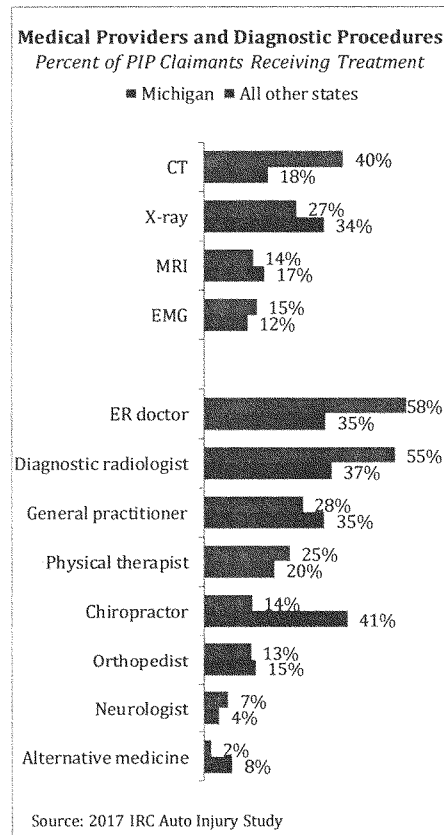
The unlimited medical benefits in Michigan lead to differences in the profile of Michigan claimants. Previous IRC research showed that Michigan claimants were more likely than those in other states to experience some degree of temporary or permanent disability and to experience 10 or more days in which they were unable to perform their usual daily activities.⁶ As a result, some significant differences existed in medical treatment reported. Moreover, many no-fault states have established fee schedules for medical services covered under PIP plans, with reimbursement amount usually tied to a workers' compensation or Medicare fee schedule. Michigan's PIP system does not include any such mechanism

to help control cost or utilization, creating the opportunity for significant cost-shifting from other types of healthcare coverage.

Looking at differences in medical utilization, Michigan claimants were somewhat less likely to have x-rays and significantly more likely to receive computerized tomography (CT) scans. Forty percent of Michigan PIP claimants received CT scans in 2017, more than double the rate among PIP claimants in the rest of the country. One Michigan PIP study found that the reimbursement for a neck CT was \$262 under Medicare, \$419 under the state's workers' compensation schedule, and \$1,820 under no-fault.⁷

The most commonly used medical professional was an emergency room (ER) doctor; 58 percent of Michigan claimants were treated by an ER doctor, compared with 35 percent of claimants elsewhere. Corresponding to the high utilization of CTs, the use of diagnostic radiologists was significantly higher in Michigan: 55 percent compared with 37 percent in other states. Chiropractic and alternative medical treatment were less common in Michigan; 14 percent of Michigan claimants received chiropractic treatment, compared with 41 percent in other states.

More research is needed to develop a more thorough and current understanding of the differentials in medical pricing and incentives for cost shifting and claim shifting.



⁶Insurance Research Council, *Affordability in Auto Injury Insurance: Cost Drivers in Twelve Jurisdictions* (Malvern, Pa.: Insurance Research Council, 2016), p. 39.

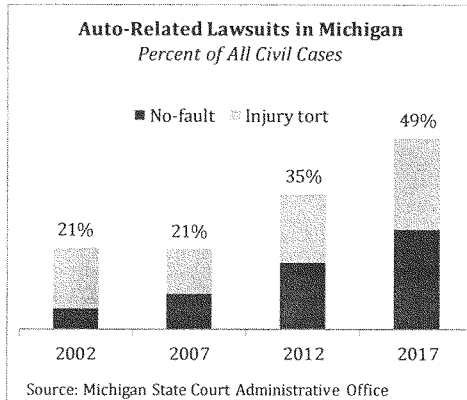
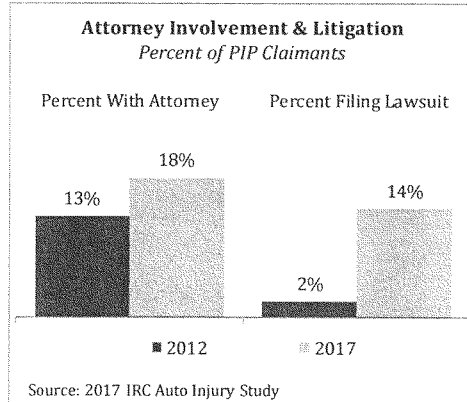
⁷Citizens Research Council of Michigan, *Medical Costs of No-Fault Automobile Insurance* (Livonia, Mich.: Citizens Research Council, 2013), p. 7.

Attorney Involvement and Litigation on the Rise

Previous IRC research has shown that attorney involvement in auto injury claims is often associated with factors that increase insurance costs.⁸ The rate of attorney involvement and litigation in PIP claims in Michigan has historically been lower than in many other no-fault states, most notably Florida and New York. However, the percentage of PIP claimants with attorneys has been increasing rapidly in recent years. It rose from 13 percent in 2012 to 18 percent in 2017. The increase in lawsuits filed has been even more dramatic, rising from 2 percent in 2012 to 14 percent in 2017.

The percentage of claims with attorney involvement is typically higher than the percentage with lawsuits. An IRC survey of auto injury claimants countrywide found that several other services provided by attorneys were more common than filing lawsuits.⁹ These included filing insurance claims on the claimant's behalf, negotiating settlements with the other driver's insurer or the claimant's own insurer, helping to arrange medical-bill payment while the claim was pending, and advising which doctors the claimant should use.

Records from the state's court system confirm the trend of increasing PIP litigation. According to statistics from the Michigan State Court Administrative Office, the number of auto-related lawsuits increased 78 percent from 2002 through 2017. Most of that increase was from a flood of no-fault cases. In 2002, lawsuits over no-fault insurance were fairly uncommon, accounting for just 5 percent of all civil cases. Most auto-related lawsuits involved injury tort claims. The number of no-fault cases more than tripled over the next 15 years, accounting for 26 percent of all civil cases in 2017. Nearly half of the system's civil caseload stemmed from auto-related cases.



⁸Insurance Research Council, *Attorney Involvement in Auto Injury Claims*, (Malvern, Pa.: Insurance Research Council, 2014), pp. 21-27.

⁹Insurance Research Council, *Motivation for Attorney Involvement in Auto Injury Claims*, (Malvern, Pa.: Insurance Research Council, 2016), p. 24.

Cost Drivers in Detroit

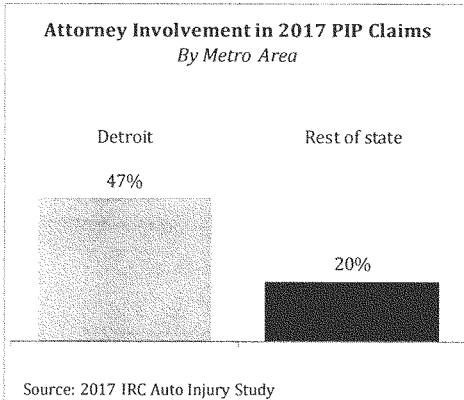
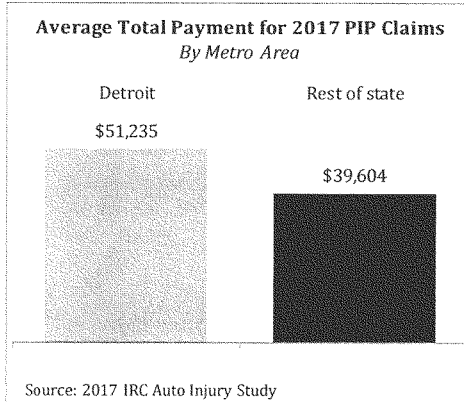
In nearly every state, the auto injury claims of large metropolitan areas are quite different from those filed elsewhere in the state. On average, claims in metropolitan areas involve higher medical utilization rates, more frequent attorney involvement and lawsuits, and larger settlements. Michigan is no exception. In fact, Detroit often tops lists of the nation's most expensive cities for auto insurance.¹⁰

Among PIP claims closed with payment in 2017, the average payment among claimants in the Detroit area was \$51,235, 30 percent higher than in the rest of the state.

Claimants in the Detroit area were more likely to hire attorneys and file lawsuits.

Nearly half of PIP claims in the Detroit area involved attorneys, compared with 20 percent of claims in the rest of the state. Similarly, the percentage of claims that involved lawsuits was significantly higher in Detroit than in the rest of the state at 41 percent compared with 12 percent.

Similar to statewide trends, court data for Wayne County, Michigan, which includes Detroit, shows an explosion in no-fault litigation. The number of lawsuits involving no-fault claims nearly tripled from 2007 through 2017. No-fault lawsuits accounted for 37 percent of the total civil caseload and more than half of the new civil filings in Wayne County circuit courts in 2017.



¹⁰For example: Kyle Magin, "The Five Most Expensive U.S. Cities for Car Insurance," March 8, 2018, <https://www.dmv.org/articles/top-five-cities-for-expensive-auto-insurance> (accessed March 29, 2019).

List of IRC Publications

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Publications listed here are available from the Insurance Research Council.

Recent IRC Publications

Please visit the IRC's website at www.Insurance-Research.org for more information on the recent research listed below or any existing IRC research.

Auto Injury Claims and Trends

Auto Insurance Affordability: Cost Drivers in Michigan, April 2019, 10 pages.

The report continues the IRC's examination of key cost drivers in selected states. The specific factors driving high insurance claim costs can vary from state to state. This report looks specifically at injury claim severity, the impact of unlimited benefits, medical treatment, and attorney involvement.

Trends in Auto Injury Claims, 2019 Edition, February 2019, 80 pages.

This report examines the frequency, severity, and loss costs associated with auto injury insurance claims under the property damage and bodily injury liability and personal injury protection coverages from 1990 through 2017. Countrywide and individual state outcomes and trends are analyzed.

Auto Insurance Affordability: Cost Drivers in Florida, December 2018, 13 pages.

The report continues the IRC's examination of key cost drivers in selected states. The specific factors driving high insurance claim costs can vary from state to state. This report looks specifically at accident frequency, injury claim frequency, medical treatment, attorney involvement, and some impacts from the 2012 PIP reforms.

Auto Insurance Affordability: Cost Drivers in Louisiana, October 2018, 12 pages.

The report is part of a larger body of IRC research examining the issue of affordability by identifying the key underlying cost drivers. The specific factors driving high insurance claim costs can vary from state to state. This report looks specifically at accident frequency, injury claim frequency, and attorney involvement.

Third-Party Bad Faith in Florida's Automobile Insurance System, 2018 Update, August 2018, 9 pages.

Bad-faith lawsuits targeting automobile insurers in Florida impose a heavy burden on the state's auto insurance system and auto insurance consumers. This report examines the effect that potential bad-faith settlements have on underlying claiming behavior in Florida. Estimates of additional claim costs attributable to the bad-faith legal environment are included.

Digitizing the Auto Insurance Customer Relationship, August 2018, 44 pages.

This survey report explores the degree to which customers want to interact digitally with their insurer and their expectations when they do so. Expectations when communicating with insurers to accomplish specific tasks are examined.

Countrywide Patterns in Auto Injury Insurance Claims, April 2018, 59 pages.

This closed-claim study is based on a sample of more than 80,000 auto injury claims paid in 2017 and examines trends in claim patterns, including injuries, medical treatment, losses and payments, the claim settlement process, and attorney involvement. The report compares 2017 data with results from similar studies conducted in 2012 and earlier.

Motivation for Attorney Involvement in Auto Injury Claims, November 2016, 41 pages.

This study examines the role of attorneys in the process of settling of auto injury claims. In an online survey, respondents who were injured in auto accidents were asked about their experience, including satisfaction with the claim process, their decision of whether to talk to or hire an attorney, and the services provided by attorneys.

Affordability in Auto Injury Insurance: Cost Drivers in Twelve Jurisdictions, June 2016, 132 pages.

This study identifies and documents the common and unique factors and conditions underlying rising auto injury insurance claim costs in 12 jurisdictions (Delaware, District of Columbia, Florida, Kentucky, Louisiana, Michigan, Mississippi, Nevada, New Jersey, New York, Rhode Island, and West Virginia).

Trends in Auto Insurance Affordability, August 2015, 48 pages.

This report monitors trends in auto insurance affordability across states and over time using the IRC's auto insurance expenditure-to-income ratio. Using Consumer Expenditure Survey data, the report also analyzes auto insurance affordability trends for low- to moderate-income consumers and inspects differences in affordability trends across various goods and services.

Fraud and Buildup and Auto Injury Claims, January 2015, 48 pages.

This report provides a unique perspective on claim abuse among auto injury claims closed with payment. Using 2012 closed-claim data, it describes the prevalence of fraud and buildup among the five main private passenger coverages and includes an analysis of different types of abuse, estimates of the excess payments attributable to fraud and buildup, and variations by state.

Attorney Involvement in Auto Injury Claims, July 2014, 50 pages.

This report uses data from the 2012 closed-claim study to examine trends in the rate of attorney involvement in auto injury claims over time and across states. It also provides details on the interaction between the presence of attorneys and cost drivers, such as medical treatment and claim abuse, and looks at how represented claimants fare compared with claimants without attorneys with respect to claim payment and time to settlement.

Uninsured Motorists***Uninsured Motorists, 2017 Edition***, October 2017, 58 pages.

This study examines trends in the percentage of uninsured motorists in each state based on uninsured motorists and bodily injury claim frequencies from 2013 through 2015. This report includes previous estimates beginning in 1999.

The Potential Effects of No Pay, No Play Laws, November 2012, 31 pages.

This study seeks to measure the impact of no pay, no play laws on the percentage of uninsured motorists. It also estimates the costs of noneconomic damages awarded to uninsured motorists in states that have yet to enact such laws. The findings suggest that not only would a properly enforced no pay, no play law result in a moderate decrease in uninsured motorists, but it may also reduce auto insurance costs.

Other Issues***Smart Home Technology***, January 2018, 40 pages.

This study explores public interest in smart home technology and the willingness to accept devices and systems that involve sharing information about the status of the home with an insurance company. It also identifies program features that may encourage consumers to allow insurers to receive information about the status of their home.

Public Understanding of Hurricane Deductibles, June 2017, 40 pages.

This report examines public understanding of the nature and effects of hurricane deductibles and other special deductibles that are applicable to storm-related homeowners insurance claims. The study is based on a survey of privately insured homeowners in five coastal states.

Attorney Involvement in Homeowners Insurance Claims in Texas, May 2017, 36 pages.

This study examines a sample of closed homeowners insurance claims for property damage occurring from 2008 through 2013, exploring the distribution of the number of claims and the dollars paid across regions within the state. The rate of attorney involvement is examined, with particular focus on claims stemming from wind and hail damage. The report documents the spread of attorney involvement across counties in Texas and provides estimates for the impact of continued increases.

The Sharing Economy: Public Participation and Views, August 2016, 58 pages.

This study examines public familiarity with and participation in the sharing economy. Also explored in the report are various insurance-related aspects of the sharing economy. The study is based on the responses of 1,105 participants in a survey fielded by GIK Public Affairs & Corporate Communications.

Auto Insurance Telematics: Consumer Attitudes and Opinions, November 2015, 25 pages.

This report explores consumer attitudes and opinions with respect to auto insurance telematics and usage-based insurance. The report finds that many drivers participating in the programs change their driving behavior in response to information provided by their insurance companies about their driving gathered with a telematics device. The report also confirms that many drivers are concerned about the privacy of their personal information.

Shopping for Auto Insurance and the Use of Internet-Based Technology, June 2015, 39 pages.

This report examines how often consumers shop for auto insurance, how they go about shopping, the choices made after shopping, satisfaction with the shopping experience, and the use of internet-based personal technology when shopping for insurance. The report also looks at differences in shopping behavior and technology use across demographic groups.

Insurance Research Council

The Insurance Research Council is a division of The American Institute for Chartered Property Casualty Underwriters (The Institutes), a not-for-profit organization dedicated to providing educational programs, professional certification, and research for the property-casualty insurance business. The IRC's purpose is to provide timely and reliable research to all parties involved in the public policy issues affecting risk and insurance, but the IRC does not lobby or take legislative positions. The IRC is supported by leading property-casualty insurance organizations.

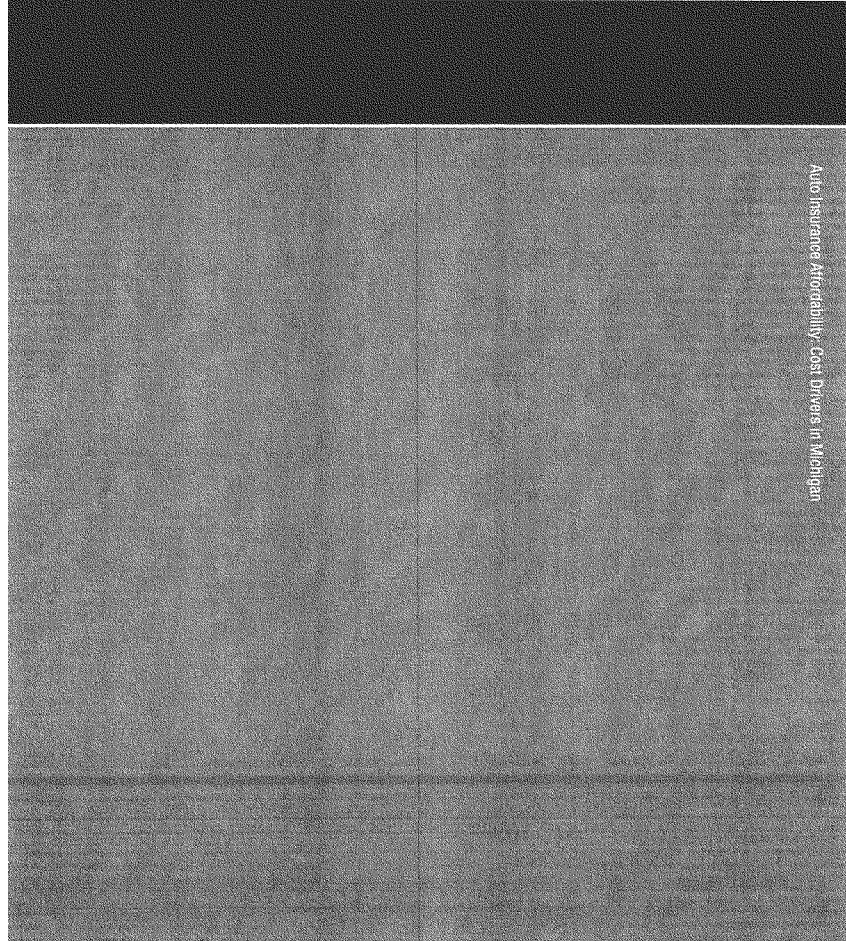
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April 29, 2019

The Honorable Al Green
Chairman
Subcommittee on Oversight and
Investigations
House Financial Services Committee
Washington, DC 20510

The Honorable Andy Barr
Ranking Member
Subcommittee on Oversight and
Investigations
House Financial Services Committee
Washington, DC 20510

Dear Chairman Green and Ranking Member Barr:

We write regarding the upcoming hearing in your subcommittee entitled, "Examining Discrimination in the Automobile Loan and Insurance Industries." As the trade associations representing the vast majority of the U.S. auto insurance market, we hope to provide a helpful perspective on behalf of our members.

As you know, we strongly support the state-based insurance regulatory system and the states have continually demonstrated their ability to successfully regulate insurance underwriting and rate-setting practices. The 1945 McCarran-Ferguson Act codified and reinforced that regime. In enacting McCarran-Ferguson, Congress then and since has recognized that state officials are in a unique position to regulate insurance through a robust framework of state laws, industry-wide regulations, and individual company market-conduct exams, as applied by nearly 11,000 state insurance regulatory employees with a full toolbox of enforcement powers. While we appreciate Congress' strong interest in protecting consumers, an interest shared by us and the states, we believe the states are in the best position to address concerns regarding insurance underwriting factors and rates.

With regard to racial discrimination, we would like to be very clear that our members strongly oppose racial discrimination in all forms and take any allegations of discrimination extremely seriously. We look forward to a dialogue on any concerns that subcommittee members may have regarding the auto insurance industry. We firmly believe that auto insurers do not discriminate on the basis of race; the states have laws and policies to prevent it; and state officials work hard every day to protect consumers from racial discrimination and do not permit it to occur. Thank you for your consideration and please let us know if you have any questions or if we can be of further assistance to the subcommittee.

Sincerely,

National Association of Mutual Insurance Companies
Independent Insurance Agents & Brokers of America
National Association of Professional Insurance Agents
American Property Casualty Insurance Association



Statement

of the

National Association of Mutual Insurance Companies

to the

United States House of Representatives

Committee on Financial Services

Subcommittee on Subcommittee on Oversight and Investigations

Hearing on

“Examining Discrimination in the Automobile Loan and Insurance Industries”

Rayburn House Office Building

May 1, 2019

The National Association of Mutual Insurance Companies is respectfully offering this statement to the United States House of Representatives Committee on Financial Services Subcommittee on Subcommittee on Oversight and Investigations for its Hearing on “Examining Discrimination in the Automobile Loan and Insurance Industries.”

NAMIC is the oldest property/casualty insurance trade association in the country, with more than 1,400-member companies representing 41 percent of the total market. NAMIC supports regional and local mutual insurance companies on main streets across America and many of the country’s largest national insurers. NAMIC member companies serve more than 170 million policyholders and write more than \$230 billion in annual premiums. Our members account for 54 percent of homeowners, 47 percent of automobile, and 32 percent of the business insurance markets.

Insurance Scores and Auto Insurance

Insurance scores (also called “credit-based insurance scores”) are confidential numerical ratings based in whole or in part on a consumer’s credit ratings. Many insurers use these scores in conjunction with other factors to underwrite and price personal automobile insurance policies, so as to most appropriately match an offered rate to the risk represented.

Insurance scores are not the same as credit scores. Credit scores predict credit delinquency while insurance scores are used to predict insurance losses. While both are based on an individual’s credit report, an insurance score is a tool that actuarially predicts the risk of an insurance loss. While many factors are used in the overall underwriting process, when calculating the insurance score, information such as income, ethnic group, age, gender, disability, religion, address, marital status and nationality are not considered.

Insurance underwriting and rating processes are designed to differentiate good risks from bad risks. To comply with state insurance regulations and offer competitive rates, an auto insurance company must be able to assess risks and price policies accurately according to the likely cost of claims generated by those policies. To be clear, insurers are prohibited from setting rates that unfairly discriminate against any individual by law in every state.

Many insurance companies use insurance scores for underwriting and rating because there are recognized actuarial, academic, and scientific studies that prove there is a strong relationship between insurance scores and insurance losses. And just as insurance scores help insurance companies assess and price risks, so too can these scores help insurance customers¹. Many

¹ <https://insurance.arkansas.gov/uploads/resource/documents/2017credit.pdf> In 2016 for some 3.4 million personal lines policies, 54.5 percent of those policies had a decrease in the final premium. In 19.8 percent of cases, it resulted in an increase. Credit scoring was a neutral factor—meaning it did not affect the outcome—in the remaining 25.7 percent of policies. Policies for which credit information decreased the premium outnumbered policies for which it increased the premium by 2.76 to 1.

customers see lower premiums when carriers use insurance scores.

Insurance scores are an actuarially proven tool for insurers to assess risk and the use of these scores serves policyholders

Numerous studies have found that credit-based insurance scores help insurers to better assess risk and develop rates that are more actuarially accurate. These studies concluded that credit may be correlated more strongly with risk than other, more traditional factors used in underwriting and rating. The National Association of Insurance Commissioners has compiled an extensive list of studies, reports and surveys² validating the use of credit and other factors in Insurance. Subsequent reports by the state regulators of insurance in Arkansas³, Nevada⁴, Texas⁵, Vermont⁶, and Virginia⁷ concluded that:

- Using credit score, insurers can better classify and rate risks based on differences in claim experience,
- Policyholders whose **premiums are based on credit-related insurance scores tend to pay lower annual premiums** than policyholders whose premiums do not include insurance scores,
- Most policyholders benefit from the use of credit scoring, and
- For those policies in which credit played some role in determining the final premium, those receiving a decrease outnumbered those who received an increase by 2.45 to 1.

Similarly, a Federal Trade Commission report to Congress, “Credit-Based Insurance Scores: Impacts on Consumers of Automobile Insurance”⁸ A Report to Congress by the Federal Trade Commission” in July 2007 concluded that credit-based insurance scores are effective predictors of risk for automobile insurance policies. The FTC found that using scores is likely to make the price of insurance conform more closely to the risk of loss that consumers pose, resulting, on average, in higher-risk consumers paying higher premiums and lower-risk consumers paying lower premiums.

A 2016 study⁹ by Georgetown University Law Center concluded that “insurance scores are predictive of risk because they operate as a rough measure of policyholders’ “level of caution” and that “the widespread use of insurance scores in auto coverage stems from a simple fact: they

²https://www.naic.org/documents/committees_c_d_auto_insurance_study_wg_related_studies_examining_use_credit_scoring.pdf

³<https://insurance.arkansas.gov/uploads/resource/documents/2017credit.pdf>

⁴ Report on the Use of Consumer Credit and Loss Underwriting Systems,” Nevada Dept. of Business & Industry, Division of Insurance (2005)

⁵ <https://tdi.texas.gov/reports/documents/credit05sup.pdf>

⁶ Vermont Department of Financial Regulation: Study of Credit-Based Insurance Scoring (2016).

⁷ <https://rga.lis.virginia.gov/Published/2016/RD331>

⁸ <https://rga.lis.virginia.gov/Published/2016/RD331>

⁹ <https://scholarship.law.georgetown.edu/cgi/viewcontent.cgi?article=2530&context=facpub>

are predictive of claim risk.” A study¹⁰ out of the University of Texas Bureau of Business Research at the McCombs School of Business found: “The correlation between credit score and relative loss ratio is .95, which is extremely high and statistically significant. The lower a named insured’s credit score, the higher the probability that the insured will incur losses on an automobile insurance policy...” An EPIC Actuaries, LLC study¹¹ found: “Insurance scores are among the three most important risk factors for each of the six automobile coverages studied.”

Insurance scoring does not have a disparate impact or discriminate based on protected classes

Auto insurance, by its very nature, discerns between low risk and high risk. Individuals that an insurer concludes to present lower risks of loss pay less per unit of insurance than individuals who present higher risks of loss. Insurance companies invest huge amounts of money and resources into analyzing loss data and developing pricing strategies. Insurance actuaries rely on accepted principles and standards of practice to make these determinations. State insurance regulators then review these rates to prevent rates that are inadequate, excessive, or unfairly discriminatory, and to ensure that the risk classifications are based upon supportable actuarial evidence. Ratemaking then is a process of risk discrimination, but in the words of one federal¹² court, “risk discrimination is not racial discrimination.”²

Perhaps the most authoritative review of this issue has been performed by the Missouri Department of Insurance, “Financial Institutions & Professional Registration report on Private Passenger Automobile Insurance: A Review of The Market In Missouri”¹³, which looked at questions of affordability and availability of automobile insurance and analyzed 30 years of monitored insurance prices. The department’s 2018 report concluded that no evidence has been found that high minority areas are systematically overcharged relative to risk compared to low minority areas. Further, no evidence indicated that high minority areas are charged more relative to risk, nor is there an association between loss ratios and area income.

The specific question of whether insurance scoring produces rates that are unfairly discriminatory was also considered by the Michigan Supreme Court in 2010. The Court¹⁴ struck down a prohibition on use of credit scores, noting that a rate is not unfairly discriminatory if there is a “reasonable justification” for the differential in rates “supported by a reasonable classification system” and that there was a direct, linear relationship between insurance scores

¹⁰ A Statistical Analysis of the Relationship Between Credit History and Insurance Losses, Bureau of Business Research, The University of Texas at Austin, March 2003

¹¹ https://www.ask-epic.com/Publications/Relationship%20of%20Credit%20Scores_062003.pdf

¹² <https://www.justice.gov/sites/default/files/crt/legacy/2010/12/14/saunders.pdf>

¹³ <https://insurance.mo.gov/reports/documents/PrivatePassengerAutomobileInsuranceInMOrev7-11-2017.pdf>

¹⁴ https://media.lockelord.com/files/upload/Ins_Institute_of_Mich_v_Comm'r_Fin_Ins_Svcs.pdf

and risk for automobile policies. The Court concluded that the prohibition of insurance scoring would make insurance both less available and less affordable to Michigan residents.

The Michigan Court also rejected contentions that credit reports are inherently unreliable and their use therefore results in misclassification of policyholders. There are numerous state and federal provisions that provide consumer protection against credit reporting problems. The Fair Credit Reporting Act gives consumers new fraud and identity-theft protections. It allows them to opt out of information and entitles one free credit report a year upon request from the three major credit reporting agencies, Equifax, Experian and TransUnion. Consumers can obtain, examine and propose corrections in their free reports from a service¹⁵ funded by the three agencies.

While the 2016 study by Georgetown University Law Center further concluded that insurance scoring does not necessarily have a disparate impact on low income policyholders, there have been recent media reports using flawed methodologies to purport that insurers were charging statistically significantly higher premiums in predominantly minority zip codes. The discussion is significantly compromised by conflating “compositional effects” (risk differences associated with individuals residing in an area) with “area effects” (the risk arising from characteristics of the area itself, such as traffic density). More seriously the selection of a subset of ZIP codes for analysis introduced a strong statistical bias into the analysis. Namely, the subset of low-minority ZIP codes was composed of predominantly rural, sparsely populated areas with little to no statistical credibility and anomalously high losses.

Regulation of Insurance Scoring is a State Authority

States have stringent anti-discrimination provisions in general and specifically with respect to insurance. There is no data to indicate that these provisions or their enforcement have been inadequate or lacking in any aspect. Existing federal anti-discrimination provisions may apply as well.

Several states have adopted laws on credit or regulations based largely on the National Conference of Insurance Legislators’ model law, and other states have enacted laws that closely follow NCOIL’s provision that prohibits an insurer from denying, canceling, or nonrenewing a policy of personal insurance solely based on credit information without consideration of any other applicable underwriting factor independent of credit information.

Finally, any federal law or regulation that would prohibit or limit the use of insurance scoring is contrary to and prohibited by the McCarran-Ferguson Act, which was passed by Congress in 1945 to ensure the preeminence of state regulation of insurance. Under the act, “No Act of Congress shall be construed to invalidate, impair or supersede any law enacted by any State for

¹⁵ <https://www.annualcreditreport.com/index.action>

the purpose of regulating the business of insurance, or which imposes a fee or a tax upon such business." The McCarran-Ferguson Act gives primary authority over insurance regulation to the states. It is imperative that stability in insurance marketplaces is achieved for the benefit of all consumers. Altering longstanding usage of actuarial sound principles for companies to legally price the risk they undertake can have dramatic and unintended consequences.

Conclusion

Objective analysis and research have shown that insurance scores are a proven actuarial tool for insurers to assess risk, and that the use of these scores more often than not serves to benefit policyholders. Similarly, objective analysis has disproven claims that insurance scores have had discriminatory or disparate impact on protected classes. Further, state-based insurance regulation provides an ample and time-tested framework for oversight in this area, which is properly preserved for the states and therefore.

**Written Statement of the National Automobile Dealers Association
Submitted For the Hearing On
“Examining Discrimination in the Automobile Loan and Insurance Industries”
Before the Subcommittee on Oversight and Investigations of the
Committee on Financial Services U.S. House of Representatives
May 1, 2019**

The National Automobile Dealers Association (NADA) is a national trade association representing more than 16,000 franchised new car and truck dealers that collectively employ more than 1 million individuals.¹ NADA is pleased to submit comments for the record to explain how dealer-assisted financing expands credit access and helps make vehicles affordable for consumers.

As the Subcommittee examines studies related to auto financing, NADA respectfully urges Congress to carefully analyze the data some organizations have released, since there are numerous examples of outdated, incomplete, and misleading research regarding fair lending concerns that do not accurately represent the current auto finance market.

NADA strongly supports fair-lending protections and has promoted vigorous compliance with our nation’s fair credit laws (see attached “Our Commitment to Fair Credit”). The dealers’ commitment to fair lending is demonstrated by the voluntary creation, implementation and promotion of NADA’s proactive Fair Credit Compliance Program², based on a Department of Justice (DOJ) model, which effectively manages fair credit risk while preserving discounts on credit for legitimate business reasons, such as meeting consumer budget constraints and competing offers. NADA, the National Association of Minority Automobile Dealers, and the American International Automobile Dealer Association jointly released this program, and numerous fair credit experts across the country have endorsed this approach.

We appreciate the opportunity to provide additional material to ensure the Subcommittee’s oversight includes balanced information and considers the benefits of a competitive marketplace for all vehicle buyers.

Dealer-Assisted Financing Makes Credit More Accessible and Affordable for Consumers

Dealer-assisted financing (which is also referred to as “indirect financing”) promotes competition and vehicle affordability for consumers. This is true for many reasons including the overall efficiency of the model and the fact that auto dealers have relationships with a wide variety of banks, credit unions and finance companies. The result of all this is that dealers can offer consumers competitive financing right at the dealership. Dealer-assisted financing allows consumers to benefit from dealers’ access to many lenders (including lenders the consumer could not access directly), all vying to provide vehicle financing to consumers.³

¹ NADA members are primarily engaged in the retail sale and lease of new and used motor vehicles, and engage in automotive service, repairs, and parts sales. Last year America’s franchised new car and truck dealers sold or leased more than 17 million new cars and light duty trucks. NADA members operate in almost every congressional district in the country, and the majority of our members are small businesses as defined by the Small Business Administration.

² <https://www.nada.org/WorkArea/DownloadAsset.aspx?id=21474838176>

³ Dealers create the competitive market where lenders such as banks and credit unions compete against other lenders, and dealers compete against other dealers for consumer business. Dealers’ ability to meet or beat competing offers generates downward pressure on all prices as other lenders in the market know the dealer can negotiate down to win the sale.

In this indirect financing model, the dealer absorbs the retail costs of marketing and distributing the loan, costs which but for the dealer the ultimate lender would need to incur itself.⁴ The consumer often benefits because the dealer is typically more efficient in overseeing those localized costs and the dealer has the flexibility to discount its retail margin by lowering the consumer's APR to beat a competing offer or to fit the customer's budget. Dealer-assisted financing routinely provides vehicle buyers with better finance rates than they could get on their own from a bank or credit union.

The Current Competitive Market for Indirect Auto Finance Facilitates Interest Rate Discounts

Indirect auto lenders impose maximum contract rates, caps that limit dealer compensation for arranging dealer-assisted financing. Dealer compensation caps for indirect auto financing have been nearly universally present for more than a decade.⁵ These caps provide a dealer financing market that operates under a competitive "mark-down" system. The finance source underwrites and funds the auto loan and sets the maximum annual percentage rate (APR) based on the borrower's credit history. The dealer either offers that maximum rate or discounts it to meet market competition and benefit the consumer. Moreover, the strong competitive forces of the vehicle finance marketplace also operate to keep both APRs low and dealer compensation, on average, well below these caps.⁶

In 2013, the Consumer Financial Protection Bureau's (CFPB) issued auto finance guidance⁷ that pressured auto lenders to eliminate or limit a dealer's ability to discount credit for consumers. The CFPB guidance attempted to change the \$1.1 trillion auto loan market and limit market competition without prior public comment, using flawed analytical methods and without studying or considering the impact of the guidance on consumers.⁸ By limiting market competition, the CFPB's policy would have increased the overall cost of auto loans for consumers and potentially pushed the marginally creditworthy out of the auto market.

In 2018 Congress passed S.J.Res. 57 with bipartisan support to disapprove the CFPB auto finance guidance and preserve the ability of a dealer to cut into its own retail margin by discounting the APR offered to consumers to finance vehicle purchases. The resolution was similar to H.R. 1737, which also

Infographic - <https://www.nada.org/assets/0/21474836471/21474836597/21474836680/21474836902/21474837018/3791c544-31d2-4afd-9a2c-3424ac5a077d.jpg>

⁴ Dealer participation, "or "dealer reserve," is the retail margin a dealer may earn for originating an indirect auto loan. In other words, it is the retail return on a dealer's investments for absorbing the costs related to serving as the "storefront" for indirect lenders. Like every other lender, the dealer receives this compensation for performing the essential retail distribution for this financing. These costs include salaries for dealer finance staff, point of sale compliance, software, utilities, and other overhead.

⁵ In the late 1990s and early 2000s lawsuits were brought against auto finance companies (not dealers) alleging disparate impact, unintentional discrimination, in auto lending. Serious questions were raised about the quality of the data and the legitimacy of the statistical analyses that formed the basis of the claims. Nonetheless, those cases were settled and the settlements included caps on dealer compensation.

Importantly, notwithstanding that the settlement agreements that first established the caps at that handful of lenders that entered into the settlements have all now expired, these caps have remained in place and are now standard in the industry for virtually all lenders including the overwhelming majority that were not involved in the litigation. Moreover, in many instances, today's caps are significantly lower than the caps that were agreed to in the original settlements. Assertions that there are no caps in the marketplace today are simply (and grossly) erroneous.

⁶ For example, a robust refinancing market exists in auto finance. The existence of this market further disciplines the pricing that is offered when auto loans are first originated because, if the auto loan carries an APR that is above-market, it will easily be refinanced and the original lender will lose the business that the original loan represented.

⁷ CFPB Bulletin 2013-02, issued March 21, 2013: http://files.consumerfinance.gov/f/201303_cfpb_march_-Auto-FinanceBulletin.pdf 2

⁸ In response to a letter sent by 22 Senators on this topic, the CFPB acknowledged that it never studied how eliminating a dealer's ability to discount credit would affect the cost of credit paid by consumers. (Letter from the Hon. Richard Cordray, Director, CFPB to Senators Portman (R-OH) and Shaheen (D-NH) (Nov. 4, 2013.)

would have rescinded the CFPB auto finance guidance and which passed the House in 2015 with the support of 88 House Democrats. NADA supported both H.R. 1737 and S.J.Res. 57, because both measures were advanced to both to ensure that proper procedures were followed in setting government policy in this area and, ultimately, to keep auto credit accessible and affordable for consumers. Significantly, S.J.Res 57 was a narrowly-tailored resolution that did not amend, change or impair the enforcement of any fair credit law or regulation.

Careful Review of Auto Finance Claims and Data Is Warranted

Congress is encouraged to closely review the statistics and other data used to allege fair credit issues since some organizations have circulated outdated, incomplete, and misleading research regarding the current vehicle loan market. For example, the National Consumer Law Center (NCLC) uses charts with outdated data to allege disparities in auto loans that are in some cases nearly two decades old and do not reflect the current auto finance market.

The NCLC bases its claims on allegations and obsolete sales data (ranging from January 1994 to September 2003) before auto lenders imposed caps that limit dealer compensation. This chart sets out data for a market that no longer exists.⁹

Another example of a flawed study that is frequently cited is the Center for Responsible Lending (CRL) report entitled “*Non-Negotiable*” which made inflammatory allegations regarding auto loans yet fails to factor in an individual’s creditworthiness when determining a loan’s interest rate. Since the 2014 CRL report did not consider the creditworthiness of the borrower, it is statistically meaningless.

Comparisons of credit are only statistically valid if borrowers are similarly situated (i.e., apples to apples). CRL instead cherry-picked minority respondents who (1) had, according to the report, “poorer credit than whites,” (2) had lower incomes, (3) purchased a higher percentage of used cars, and (4) borrowed more on average than the non-minority respondents.¹⁰ When the minority respondents claimed to pay a higher interest rate, CRL ascribed the reason solely to discrimination, instead of the fact that borrowers with poor credit pay higher interest rates than borrowers with excellent credit because of the greater risk. In fact, CRL’s report itself acknowledged that its results “do not necessarily demonstrate discrimination.”¹¹

In another widely discredited study, entitled *Under the Hood*, CRL has also alleged that dealer-assisted financing “lead[s] to more expensive loans.” Yet CRL did not provide *any* evidence in their report that dealer-assisted financing is more expensive than auto financing available from banks or credit unions.¹² In fact, what evidence exists shows that APRs are lower in indirect auto loans than in direct auto loans

⁹ The original version of the chart that was circulated by the Subcommittee omitted important introductory material that appears on the version of the chart posted on the NCLC website. That introductory material confirms that the data included is “from the late 1990s to early 2000s.” https://www.nclc.org/images/pdf/car_sales/tb-auto-dealers-racial_disparities.pdf The Subcommittee’s memo was later corrected and confirms that the entire chart ONLY depicts data from the era before caps on dealer compensation were imposed – and thus is not relevant to today’s market.

¹⁰ Center for Responsible Lending, “*Non-Negotiable*” (Jan. 23, 2014) at 8, 9.

¹¹ *Id.* at 9.

¹² A point-by-point rebuttal of the *Under the Hood* report can be found [here](#).

for similarly situated borrowers.¹³ This is the case for many reasons, including that the costs of providing indirect financing are lower than those of direct lending and that a dealer's access to many lenders vying to provide financing to consumers often provides car buyers with better finance rates than they could get on their own. It should be noted that CRL is an organization "closely affiliated"¹⁴ with the Self-Help Credit Union, an auto lender that directly competes with auto dealers.

A study by the National Fair Housing Alliance attempts to draw similarly unsubstantiated conclusions from sixteen cherry-picked auto shopping interactions, not from completed sales transactions. In a market with 17 million new sales annually, sixteen shopping transactions is such an insignificant sample size that the "study" is deprived of any statistically relevant significance. Also, the methodology of the study is not sufficiently explained to warrant specific conclusions about the price of financing. Furthermore, in several of the matched pairs transactions, the white testers would have paid more than the non-white testers, thus further eroding the study's value as evidence of widespread discrimination. Finally, the study did not use identically situated test subjects with debt to income ratios, incomes, etc.¹⁵

NCLC research also criticizes vehicle products such as service contracts and GAP (guaranteed asset protection) insurance but all the claims in the study are based on the review of data from ONE provider in the industry in 2012, as their footnote in Appendix B notes. Also, the NCLC alleges that these products are sold as mandatory products when in fact these products are voluntary. For these products to be included in the amount financed on a retail installment contract, the cost of the products must be separately stated in the contract and the consumer must separately consent to purchase the product. Lastly, this NCLC study has never been peer reviewed and the underlying data has never been released.

Finally, even some of the methods employed by the government need to be carefully reviewed. In issuing its 2013 guidance, the CFPB used a flawed method for identifying the background of consumers since their analysis was based solely on a borrower's zip code and last name.¹⁶

The Bayesian Improved Surname Geocoding (BISG) proxy methodology was designed to identify the backgrounds of specific populations, not to ascertain the specific background of an individual.¹⁷ A non-partisan study by Charles Rivers Associates of the CFPB's use of the methodology found a 41% error rate for classifying the background of a significant group of consumers. As noted above, even the CFPB's own review of its analysis revealed a 20% error rate for the same group.¹⁸ Additionally, the

¹³ NADA Comments to Federal Trade Commission re: Motor Vehicle Roundtables, Appendix A (Mar. 30, 2012), available at https://www.ftc.gov/sites/default/files/documents/public_comments/public-roundtables-protecting-consumers-sale-and-leasing-motor-vehicles-project-no.p104811-00105/00105-82872.pdf.

¹⁴ Center for Responsible Lending, "Non-Negotiable" Jan. 2014, p. 31.

¹⁵ A correct fair lending analysis must identify and compare similarly situated consumers by holding constant variables such as the amount financed; trade-in value; competition in the local market; market conditions; demand and desirability for the vehicle; the consumer's payment capacity; and whether the car is new or used.

¹⁶ Under previous leadership, the CFPB failed for three years to provide Congress policy analysis and answer direct questions to substantiate the guidance. Despite receiving 13 letters from Congress, signed by over 90 bipartisan Members and Senators, the Bureau never explained their analysis supporting the elimination of consumer discounts or fully answered fundamental questions raised by Congress.

¹⁷ <https://www.latimes.com/business/la-fi-rand-elliott-20160824-snap-story.html>.

¹⁸ Using publicly available information to proxy for unidentified race and ethnicity: A methodology and assessment (2014), Table 10. https://files.consumerfinance.gov/f/201409_cfpb_report_proxy-methodology.pdf.

Charles River study revealed that CFPB's analysis was "conceptually flawed and subject to significant bias and estimation error."

The study noted that for a correct fair lending analysis, the CFPB must ensure the consumers compared are similarly situated by holding key variables constant, including the following: (1) the amount financed; (2) trade-in value; (3) competition in the local market; (4) market conditions; (5) demand and desirability for the vehicle; (6) consumer's payment capacity; and (7) whether the car is new or used. Also, manufacturers provide dealers sales incentives that can operate to motivate a dealer to arrange financing a car at a discount or loss in order to achieve certain sales goals. If this factor is present, it must be taken into consideration as a dealer often has a vested interest in selling the car at a financing discount both to make the sale and to create customer loyalty that results in return business for parts, service, and future car purchases.

The Charles River study found that the CFPB's findings of variations in interest rates were significantly overstated and failed to consider legitimate and lawful factors, such as budget constraints and competing offers, which explain why a dealer may discount an interest rate and why prices vary from consumer to consumer.¹⁹ Especially in the context of this hearing, it is important to note that a rebuttal of the comprehensive Charles River study has never issued. See also *Fair Credit for Auto Loans: Too Important to Get Wrong*.²⁰

Why then did Ally Bank settle with the Department of Justice and the CFPB, when the CFPB was using a flawed methodology for identifying the background of consumers? Unfortunately, Ally could not rebut the CFPB's assertions because the Bureau refused to inform Ally how it had calculated fair lending bias.²¹

Additionally, the CFPB is a powerful regulator with tremendous leverage over lenders, and but for several factors, which were unrelated to the auto lending issue, it is unclear whether Ally Bank would have settled with the CFPB:

According to Ally's then-CEO, Ally was motivated to settle with the CFPB because of "...a desire to get the consent order behind it so it could move forward on other urgent business."²² That urgent business included getting the Federal Reserve Board to approve Ally's application to become a financial holding company, enabling Ally to continue offering insurance products and services that Ally might have been forced to discontinue. According to the *Wall Street Journal*, "Standard & Poor's Ratings Services... warned it would potentially lower the company's ratings if it failed to secure financial holding company status."²³ Ally's application was approved three days after Ally signed the consent order, and "the CFPB was one of a number of regulators that had input on the Federal Reserve's decision on financial holding

¹⁹ Charles River Associates, *Fair Lending: Implications for the Indirect Auto Finance Market* at 4 (Nov. 2014).

²⁰ Infographic: *Fair Credit for Auto Loans: Too Important for the CFPB to Get Wrong* (2017).

company status.”²⁴

Ally Bank was also motivated to settle because of its impending initial public offering. CFPB was aware of this fact, as the federal government owned 64 percent controlling interest in Ally Bank at the time. The then-CEO of Ally Bank told the press, “[n]o investor publicly was going to invest in us unless we got financial holding company status. And we could not do that without coming to terms with the CFPB.”²⁵ On March 27, 2013, Ally announced an IPO where the U.S. government “would sell the bulk of its stake in the company.”²⁶

Conclusion

We end our comments to the Subcommittee where we began. In addition to analytical points we have raised, NADA would like to reiterate its strong commitment to fair credit. And we not only publicly state our position, we proactively provide our members with the tools they need to help implement this approach. From our Fair Credit Compliance Policy and Program to our extensive training and educational offerings to our recently released Voluntary Protection Products Policy and Program, NADA stands ready to help ensure that the vehicle financing market both addresses fair credit concerns and retains the flexibility needed to ensure that consumers can get competitively-priced, affordable credit.

NADA looks forward to working with the Subcommittee to keep auto financing competitive and to assist consumers and their families as they seek affordable transportation.

Attachments:

NADA: Our Commitment to Fair Credit

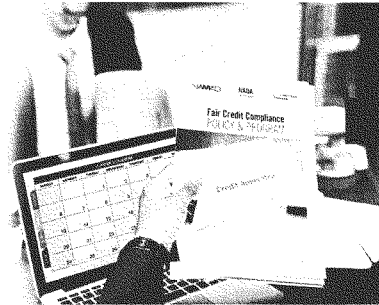
Fair Credit for Auto Loans: Too Important to Get Wrong



NATIONAL AUTOMOBILE DEALERS ASSOCIATION
Visit nada.org to learn more

Our Commitment to Fair Credit

by PETER WELCH, NADA



In today's market, America's new car and truck dealerships sell around 50,000 new cars and trucks a day. Consumer access to affordable credit at dealerships, and interest rate discounts that local dealerships can provide their customers, are keys to driving those sales. Congress recently repealed a lending guidance issued by the federal Consumer Financial Protection Bureau (CFPB) that threatened to adversely affect dealer competition and consumers' access to interest rate discounts. The guidance was repealed because of serious agency process concerns, and because it inadequately recognized that dealerships can provide competitive credit while fully adhering to our nation's fair credit laws. NADA is firmly committed to helping dealerships achieve both key objectives.

Adherence to non-discriminatory access to credit remains a core value for America's new car and truck dealers. Simply put, the CFPB guidance is gone, but the anti-discrimination laws governing lending, like the Equal Credit Opportunity Act (ECOA), are not. The fair credit laws that govern dealer conduct remain part of the fabric of the law. Beyond the law, those statutes underscore a moral imperative to avoid discrimination and to treat all customers fairly and with respect.

Four and a half years ago, based on our twin commitments to competitive credit and fair lending, NADA partnered with the American International Automobile Dealers Association (AIADA) and the National Association of Minority Automobile Dealers (NAMAD) on a simple but incredibly important initiative. We sought to develop a compliance framework, available to all dealers on a voluntary basis, that enhances the ability of participating dealers to comply with

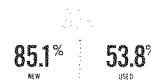
our nation's fair credit laws while retaining the flexibility needed to meet the borrowing needs of the nation's car buyers.

Recognizing the need to promote these important goals, we re-examined a crucial question: Can fair lending compliance and consumer interest rate discounts coexist? Fortunately, the U.S. Department of Justice (DOJ), which had also been considering the issue for a long period of time, clearly determined that the answer was "yes."

Building on that conclusion, we developed a program that promotes compliance by better structuring the exemption-based discounting system that has long been the hallmark of an ECOA-compliant indirect auto financing market. The improved approach was designed to ensure that discounting remained possible but only in ways that assured that similarly situated people were treated the same,

PERCENTAGE OF VEHICLES WITH FINANCING

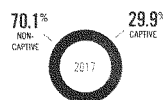
In 2017, 85.1% of new-vehicle buyers and 53.8% of used-vehicle buyers financed their purchases.



TOTAL U.S. AUTO LOAN BALANCE (2013-2017)



MARKET SHARE OF TOTAL FINANCING (new/used units and loan/lease)



Peter Welch is President & CEO of the National Automobile Dealers Association.

Learn more at nada.org/faircredit



NATIONAL AUTOMOBILE DEALERS ASSOCIATION
Visit nada.org to learn more

regardless of race, national origin, religion, sex, age, or other protected characteristics.

How did we come up with this framework for maintaining fair credit compliance while preserving discounting? We didn't—the DOJ did.

In 2007, the DOJ entered into consent orders with two dealerships to resolve allegations of fair credit violations. These allegations were remarkably similar to the more recent ones brought against indirect finance sources by the CFPB.

Importantly, these DOJ consent orders did not eliminate either dealer participation or a dealer's ability to offer discounts. Instead, to permit consumers to continue receiving the tremendous benefits of discounting, the consent orders required the dealers to standardize the initial amount of dealer participation included in all retail installment sale contracts, and allowed deviations from that standard amount only in the presence of a legitimate business justification, such as a competing credit offer from another lender or a monthly budget constraint on the part of the customer.

It was a well-balanced and effective solution. Which is exactly why the NADA/AIADA/NAMAD Fair Credit Compliance Policy and Program (the Program) further operationalizes the DOJ framework and makes it available to all dealers. Just like the DOJ consent orders, the Program's approach takes race and other protected characteristics out of the equation entirely; it calls for a dealer who adopts the Program to standardize the amount of dealer participation for every customer, and only allows that dealer to deviate in one direction (downward), and only in response to a legitimate business reason—like marking down a rate to meet a competing offer or monthly budget constraint—that has nothing to do with race or any non-business factor.

NADA believes the Program represents the best approach to promote compliance with ECOA while preserving enough flexibility to allow customers to continue leveraging the overwhelming benefits that are produced by today's intensely competitive vehicle financing market. Dealerships that implement the Program reduce their discrimination liability risks under ECOA, and it is also unquestionably the right thing to do. Treating customers in a fair and consistent manner and strictly abiding by all anti-discrimination laws are central to the mission and success of franchised auto dealers everywhere. The Program reflects an unambiguous commitment to both of these principles.

For these reasons, much of our focus is on making the Program even easier to implement through partnerships with providers such as CU Direct, Dealertrack, and RouteOne. Thanks to these arrangements, the Program can easily be integrated into the F&I operations of participating dealerships, as well as automated. I am confident that we will see additional progress on this front in the coming months.

As long as I am President and CEO of NADA, I will continue to encourage every franchised dealer and dealership group to adopt and implement our Program. I will also continue to seek additional bipartisan support among federal policymakers—regardless of which party is in power—and encourage them to embrace the Program as the best way to ensure fair credit compliance in auto financing.

In the meantime, it is up to our industry to lead the way. We have at our disposal a way to affirm our commitment to abide by some of our nation's most important laws while doing right by our customers. That's a commitment that every dealer should be proud to get behind. ■

FAIR CREDIT FOR AUTO LOANS

TOO IMPORTANT FOR THE CFPB TO GET WRONG

The CFPB's fair credit initiative to eliminate or limit a dealer's ability to discount auto loans for consumers has several fundamental flaws, including three major problems:

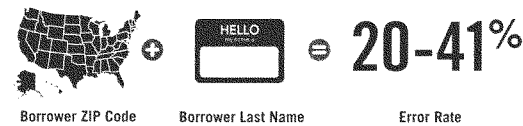
- 1 The CFPB is using an analysis for determining the background of borrowers it knows to be flawed.
- 2 Its analysis does not compare customers that are similarly situated (alike in relevant ways).
- 3 It fails to account for legitimate, competitive business factors that may explain pricing differences.

PROBLEM 1:

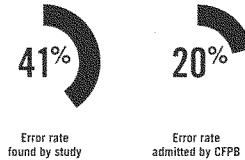
The CFPB's Consumer Analysis is Flawed

To evaluate whether dealer discounts for consumer auto loans adversely affects one group relative to another even when consistently applied, an analysis must first determine who is a member of a protected class (such as race, national origin, etc.). To determine a borrower's background, the CFPB relies on a method that: (1) was not designed to determine the background of individual borrowers; and (2) it knows to be flawed.

Flawed CFPB Method



A non-partisan study by Charles River Associates found a 41 percent error rate for classifying a significant group of minority consumers. The CFPB's own review revealed a 20 percent error rate for the same group.



PROBLEM 2:

Analysis Fails to Compare Customers that are Similarly Situated

A proper fair credit examination must ensure that consumers being compared are both appropriately classified as belonging to a protected group (based on race, national origin, etc.) and that those consumers are similarly situated. For example, the CFPB does not compare customers that are alike in relevant ways since it does not take into account factors not related to a consumer's background that may impact loan rates, such as whether a consumer is buying a new or used car or different geographic markets.

Proper Method

Belonging to a protected group (based on race, national origin, etc.)



Alike in relevant ways (similarly situated)

PROBLEM 3:

The CFPB Fails to Look at Legitimate Business Reasons

Even if the CFPB accurately classifies the background of a borrower, and then does an "apples to apples" comparison of borrowers, the Bureau would still need to take into account "legitimate business reasons" for any pricing differentials. In 2007, the Department of Justice recognized seven legitimate business reasons for dealers discounting auto loans, such as to meet a consumer's monthly budget, or when a dealer "meets or beats" competing offers from a bank, credit union or other dealer. The CFPB, however, fails to account for legitimate, competitive business factors that may explain pricing differences.



Monthly Budget



Competing Offer from Lender



Reduced Rate for Consumer

CONGRESS SHOULD HELP RESOLVE THIS IMPORTANT ISSUE

- Every consumer deserves to be treated fairly.
- The retail automobile industry has promoted a strong fair credit compliance program based entirely on the Department of Justice approach manages fair credit risk, and explains any pricing differences. The CFPB should embrace a DOJ-based program that addresses fair credit risk while preserving consumer discounts that keep auto credit affordable.
- It's important that government agencies follow due process and employ an independent and unbiased analysis, especially when dealing with such important issues of fair credit and consumer affordability.
- Congressional assistance is needed to bring this matter to a successful conclusion and to preserve consumers' access to affordable auto credit.

March 10, 2017

Congresswoman Joyce Beatty (OH-03)
Committee on Financial Services
“Examining Discrimination in the Automobile Loan and Insurance Industries”
April 30, 2019
Questions for the Record

Questions for Mr. Rivera

Question #1

Mr. Rivera, I read your report entitled, “Auto Insurance and Economic Mobility in Michigan” and I must admit that I found it compelling. However, I am perplexed as to why you left the most compelling reasons for Michigan’s, and more specifically Detroit’s, high auto insurance rates out of your testimony before this Subcommittee.

In your report you stated:

- The most frequently cited reason for Michigan’s high rates is the state’s unique form of no-fault insurance, with unlimited Personal Injury Protection.
- Michigan is the only state that requires drivers to purchase unlimited Personal Injury Protection coverage.
- While the cost of these benefits only made up 6% of premiums in 1972, they currently account for 42% of the average premiums.
- In addition, Michigan does not impose medical fee schedules, meaning that hospitals can charge auto insurers more than they can charge health insurers. This leads no-fault insurers in Michigan to be charged significantly more...for the same medical procedures.
- In 2013, the average cost per auto accident claim in Michigan was over \$75,000 – more than five times the next highest state.
- Not only are there far more PIP claims in Detroit than in surrounding suburbs, but PIP claims are for almost double the amount (\$59,000 on average, compared to \$30,000)”

- Nationally, an estimated 13 percent of drivers are uninsured. In Michigan, the corresponding rate is 20 percent, 4th highest in the Nation. In Detroit, the estimate is closer to 60 percent, more than four times higher than the national average.

This all seems to be a very compelling case as to why Michigan, and Detroit specifically, have the highest auto insurance rates in the country. From my reading of your testimony and report, you are using the fact that Michigan has the highest auto insurance rates in the country, attributing it to non-driving factors being used to make rates, and glossing over 90% of your own report that lays out a compelling argument why Michigan's unique regulatory policies lead to higher rates.

Why did you choose to leave out all these compelling reasons in your testimony before this Subcommittee for why Michigan, and Detroit specifically, have the highest auto insurance rates in the country?

Answer to Question #1

The invitation I received from the Subcommittee on Oversight and Investigations described the purpose of the hearing as follows: "This hearing will examine the auto loan and insurance-related practices and products that are potentially discriminatory or predatory in nature and the current regulatory framework governing these markets."

As such, I provided the subcommittee with written and oral testimony on the use of non-driving factors insurance rate setting as a source of discrimination in the auto insurance market.

As I noted in my testimony, many factors shape the cost of auto insurance. My statement did not cover every factor that shapes the cost of auto insurance. That decision was made not to omit any particular issue but to respect the intent for which I was asked to testify before the subcommittee.

In the future, I would be honored and happy to testify before the subcommittee on any issue for which I have expertise.

Question #2

In your testimony, you state that only 4 states have annual average insurance premiums below \$1,000 – Maine, Virginia, North Carolina, and Iowa. Do these states allow for use of non-driving related factors in calculating their insurance rates?

Answer to Question #2

Yes, Maine, Virginia, North Carolina, and Iowa allow the use of non-driving factors in calculating insurance rates. While average premiums are below \$1,000 dollars in those states, premiums vary

significantly for motorists impacted by the use of non-driving factors. For example, while average auto insurance premiums in Iowa are \$1,015 annually, drivers with very poor credit pay \$1,718.



Nathaniel F. Wienecke
Senior Vice President

April 30, 2019

Dear Members of the Michigan Congressional Delegation,

On Wednesday, May 1st, the House Financial Services' Subcommittee on Oversight and Investigations will hold a hearing entitled "Examining Discrimination in the Automobile Loan and Insurance Industries." Among the witnesses at this hearing will be Mr. Joshua Rivera, Policy Advisor for Poverty Solutions at the University of Michigan. We understand that one of the issues that Mr. Rivera – and potentially members of the subcommittee – will focus on is the affordability of auto insurance in Michigan.

The members of the American Property Casualty Insurance Association (APCIA), which provide more than 52 percent of the total auto insurance sold in Michigan, have serious concerns regarding the affordability of auto insurance in your state and are committed to addressing this issue. We appreciate that auto insurance is a necessity for many Americans, including those in Michigan, and we are pleased that the Michigan Legislature is actively considering SB 1 to fix serious problems in the auto insurance market. Unfortunately, we fear that the momentum of this important work is being coopted by some advocates to advance unrelated initiatives that actually could cause an *increase* in insurance premiums.

Mr. Rivera and Poverty Solutions recently issued a report entitled, "*Auto Insurance and Economic Mobility in Michigan: a Cycle of Poverty*," which correctly points out that Michigan's unlimited personal injury protection (PIP) system and relevant lack of cost controls bear primary responsibility for high auto insurance rates. The crux of the problem is that under Michigan law, every vehicle owner is required to have PIP coverage that provides *unlimited* lifetime medical benefits, payments for lost wages due to disability for up to three years, and a daily allowance for replacement services. By contrast, the next highest state-mandated PIP benefit coverage minimum is New Jersey's, at \$250,000.

Michigan's PIP system also lacks an objective, scientifically based medical fee schedule similar to those used by the state for Medicare and workers' compensation insurance claims. That means that medical professionals can charge whatever they choose for treating injuries resulting from auto accidents, and auto insurance companies must pay those bills regardless of how inflated they are. Collectively, these systemic defects have led to rampant fraud and litigation abuse by opportunistic personal injury attorneys and others. A 2015 Insurance Research Council Report found that 14 percent of Michigan PIP claims had the appearance of "build-up" or fraud.

In an effort to combat these abuses, former Governor Rick Snyder created an anti-fraud unit within the Department of Insurance and Financial Services in September 2018. Unfortunately, this unit is insufficiently staffed to handle the thousands of complaints that have been filed to date. The state has also established a reinsurance mechanism for limiting insurers' exposure in catastrophic lifetime claims, but the protection it offers is already very expensive and will soon become even more so, with every insured vehicle in Michigan set to incur a \$220 surcharge as of July solely for the *reinsurance* for lifetime benefits claims.

SB 1 would reform Michigan's broken PIP system by offering more choices to consumers on coverage limits, applying a fee schedule to auto medical costs, and addressing the rampant fraud and excessive litigation. APCIA is fully committed to working with stakeholders in Michigan to address this important issue, as we

have done in partnership with our members for years. However, we believe that the ability to truly discuss and address affordability in the state has been significantly impeded by certain stakeholders who would like to distract policymakers with issues that are not related to the underlying cause of unaffordability. Mainly, we have concerns with the ongoing push by certain consumer groups, including Poverty Solutions and others, to eliminate the use of credit-based insurance scores in the underwriting of auto insurance. Poverty Solutions itself, in the same report in which it addresses the true underlying cause impacting auto insurance affordability, correctly states that eliminating non-driving factors such as credit-based insurance scores "would not necessarily lower premiums across the state." This is further supported by the Arkansas Insurance Department, which has studied the use of credit-based insurance scores for over a decade and found that, on average, nearly 80 percent of consumers either received a lower premium or their premium was unaffected.

In order to help focus the important conversations that are ongoing at the local, state, and now federal level regarding affordability of Michigan auto insurance on the issues that are proven cost drivers, we would like to address credit-based insurance scores. Credit-based insurance scores have been used for more than 30 years because study after study both by academics and actuaries have confirmed that they are one of the most accurate – if not the most accurate – underwriting and rating factors available today. Their use helps insurers more accurately price insurance based on the anticipated risk that a policyholder presents. As shown in a 2016 study published in the North American Actuarial Journal, there is clear empirical evidence that credit-based insurance scores predict insurance losses in automobile insurance at a statistically significant level.

Credit-based insurance scores differ from credit scores used by lenders in several important aspects. Specifically, insurers use credit-based insurance scores to predict the likelihood of future insurance loss, while lenders use credit scores to predict the likelihood a borrower will default on his or her loan. Credit scores and credit-based insurance also differ in the way in which they are both calculated and regulated. Insurers and insurance regulators have carefully tailored the data points and methodology to ensure that credit-based insurance scores provide the most accurate risk-predictive value, while ensuring that they do not unfairly discriminate against any protected classes or income levels. This robust oversight has resulted in credit-based insurance scores continually being proven to not unfairly discriminate against minorities and other protected classes. Additionally, a study published by the Georgetown University Law Center in October 2015 definitively concluded that credit-based insurance scores do not act as a proxy for income.

Michigan drivers pay nearly 70 percent more for automobile insurance than drivers in the neighboring states of Ohio, Indiana, Illinois, and Wisconsin, each of which allows credit-based insurance scores. APCIA is pleased that the Michigan Senate is poised to consider a proposal to reform the broken PIP system, and we are hopeful the Michigan House will quickly follow suit by offering more choices to consumers on coverage limits, applying a fee schedule to auto medical costs, and adopting other meaningful reforms that will rein in rampant fraud and excessive litigation. At the same time, the Michigan Legislature should avoid taking steps that might further undermine the auto insurance market by eliminating actuarially proven underwriting factors such as credit-based insurance scoring. APCIA and our members stand ready to work with the Governor, the Michigan Legislature, and the Michigan Insurance Commissioner to help in this effort. Michigan drivers deserve a competitive insurance market that is affordable, accurately priced, and provides reasonable coverage.

Sincerely,



Nathaniel F. Wienecke

**Written Statement of the National Automobile Dealers Association
Submitted For the Hearing On
“Examining Discrimination in the Automobile Loan and Insurance Industries”
Before the Subcommittee on Oversight and Investigations of the
Committee on Financial Services U.S. House of Representatives
May 1, 2019**

The National Automobile Dealers Association (NADA) is a national trade association representing more than 16,000 franchised new car and truck dealers that collectively employ more than 1 million individuals.¹ NADA is pleased to submit comments for the record to explain how dealer-assisted financing expands credit access and helps make vehicles affordable for consumers.

As the Subcommittee examines studies related to auto financing, NADA respectfully urges Congress to carefully analyze the data some organizations have released, since there are numerous examples of outdated, incomplete, and misleading research regarding fair lending concerns that do not accurately represent the current auto finance market.

NADA strongly supports fair-lending protections and has promoted vigorous compliance with our nation's fair credit laws (see attached “Our Commitment to Fair Credit”). The dealers’ commitment to fair lending is demonstrated by the voluntary creation, implementation and promotion of NADA’s proactive Fair Credit Compliance Program², based on a Department of Justice (DOJ) model, which effectively manages fair credit risk while preserving discounts on credit for legitimate business reasons, such as meeting consumer budget constraints and competing offers. NADA, the National Association of Minority Automobile Dealers, and the American International Automobile Dealer Association jointly released this program, and numerous fair credit experts across the country have endorsed this approach.

We appreciate the opportunity to provide additional material to ensure the Subcommittee’s oversight includes balanced information and considers the benefits of a competitive marketplace for all vehicle buyers.

Dealer-Assisted Financing Makes Credit More Accessible and Affordable for Consumers

Dealer-assisted financing (which is also referred to as “indirect financing”) promotes competition and vehicle affordability for consumers. This is true for many reasons including the overall efficiency of the model and the fact that auto dealers have relationships with a wide variety of banks, credit unions and finance companies. The result of all this is that dealers can offer consumers competitive financing right at the dealership. Dealer-assisted financing allows consumers to benefit from dealers’ access to many lenders (including lenders the consumer could not access directly), all vying to provide vehicle financing to consumers.³

¹ NADA members are primarily engaged in the retail sale and lease of new and used motor vehicles, and engage in automotive service, repairs, and parts sales. Last year America’s franchised new car and truck dealers sold or leased more than 17 million new cars and light duty trucks. NADA members operate in almost every congressional district in the country, and the majority of our members are small businesses as defined by the Small Business Administration.

² <https://www.nada.org/WorkArea/DownloadAsset.aspx?id=21474838176>

³ Dealers create the competitive market where lenders such as a banks and credit unions compete against other lenders, and dealers compete against other dealers for consumer business. Dealers’ ability to meet or beat competing offers generates downward pressure on all prices as other lenders in the market know the dealer can negotiate down to win the sale.

In this indirect financing model, the dealer absorbs the retail costs of marketing and distributing the loan, costs which but for the dealer the ultimate lender would need to incur itself.⁴ The consumer often benefits because the dealer is typically more efficient in overseeing those localized costs and the dealer has the flexibility to discount its retail margin by lowering the consumer's APR to beat a competing offer or to fit the customer's budget. Dealer-assisted financing routinely provides vehicle buyers with better finance rates than they could get on their own from a bank or credit union.

The Current Competitive Market for Indirect Auto Finance Facilitates Interest Rate Discounts

Indirect auto lenders impose maximum contract rates, caps that limit dealer compensation for arranging dealer-assisted financing. Dealer compensation caps for indirect auto financing have been nearly universally present for more than a decade.⁵ These caps provide a dealer financing market that operates under a competitive "mark-down" system. The finance source underwrites and funds the auto loan and sets the maximum annual percentage rate (APR) based on the borrower's credit history. The dealer either offers that maximum rate or discounts it to meet market competition and benefit the consumer. Moreover, the strong competitive forces of the vehicle finance marketplace also operate to keep both APRs low and dealer compensation, on average, well below these caps.⁶

In 2013, the Consumer Financial Protection Bureau's (CFPB) issued auto finance guidance⁷ that pressured auto lenders to eliminate or limit a dealer's ability to discount credit for consumers. The CFPB guidance attempted to change the \$1.1 trillion auto loan market and limit market competition without prior public comment, using flawed analytical methods and without studying or considering the impact of the guidance on consumers.⁸ By limiting market competition, the CFPB's policy would have increased the overall cost of auto loans for consumers and potentially pushed the marginally creditworthy out of the auto market.

In 2018 Congress passed S.J.Res. 57 with bipartisan support to disapprove the CFPB auto finance guidance and preserve the ability of a dealer to cut into its own retail margin by discounting the APR offered to consumers to finance vehicle purchases. The resolution was similar to H.R. 1737, which also

Infographic - <https://www.nada.org/assets/0/21474836471/21474836597/21474836680/21474836902/21474837018/3791c544-31d2-4a1d-9a2c-3424ae5a077d.jpg>

⁴ Dealer participation, or "dealer reserve," is the retail margin a dealer may earn for originating an indirect auto loan. In other words, it is the retail return on a dealer's investments for absorbing the costs related to serving as the "storefront" for indirect lenders. Like every other lender, the dealer receives this compensation for performing the essential retail distribution for this financing. These costs include salaries for dealer finance staff, point of sale compliance, software, utilities, and other overhead.

⁵ In the late 1990s and early 2000s lawsuits were brought against auto finance companies (not dealers) alleging disparate impact, unintentional discrimination, in auto lending. Serious questions were raised about the quality of the data and the legitimacy of the statistical analyses that formed the basis of the claims. Nonetheless, those cases were settled and the settlements included caps on dealer compensation.

Importantly, notwithstanding that the settlement agreements that first established the caps at that handful of lenders that entered into the settlements have all now expired, these caps have remained in place and are now standard in the industry for virtually all lenders including the overwhelming majority that were not involved in the litigation. Moreover, in many instances, today's caps are significantly lower than the caps that were agreed to in the original settlements. Assertions that there are no caps in the marketplace today are simply (and grossly) erroneous.

⁶ For example, a robust refinancing market exists in auto finance. The existence of this market further disciplines the pricing that is offered when auto loans are first originated because, if the auto loan carries an APR that is above-market, it will easily be refinanced and the original lender will lose the business that the original loan represented.

⁷ CFPB Bulletin 2013-02, issued March 21, 2013: http://files.consumerfinance.gov/f/201303_cfpb_march_-Auto-FinanceBulletin.pdf 2

⁸ In response to a letter sent by 22 Senators on this topic, the CFPB acknowledged that it never studied how eliminating a dealer's ability to discount credit would affect the cost of credit paid by consumers. (Letter from the Hon. Richard Cordray, Director, CFPB to Senators Portman (R-OH) and Shaheen (D-NH) (Nov. 4, 2013.)

would have rescinded the CFPB auto finance guidance and which passed the House in 2015 with the support of 88 House Democrats. NADA supported both H.R. 1737 and S.J.Res. 57, because both measures were advanced to both to ensure that proper procedures were followed in setting government policy in this area and, ultimately, to keep auto credit accessible and affordable for consumers. Significantly, S.J.Res 57 was a narrowly-tailored resolution that did not amend, change or impair the enforcement of any fair credit law or regulation.

Careful Review of Auto Finance Claims and Data Is Warranted

Congress is encouraged to closely review the statistics and other data used to allege fair credit issues since some organizations have circulated outdated, incomplete, and misleading research regarding the current vehicle loan market. For example, the National Consumer Law Center (NCLC) uses charts with outdated data to allege disparities in auto loans that are in some cases nearly two decades old and do not reflect the current auto finance market.

The NCLC bases its claims on allegations and obsolete sales data (ranging from January 1994 to September 2003) before auto lenders imposed caps that limit dealer compensation. This chart sets out data for a market that no longer exists.⁹

Another example of a flawed study that is frequently cited is the Center for Responsible Lending (CRL) report entitled “*Non-Negotiable*” which made inflammatory allegations regarding auto loans yet fails to factor in an individual’s creditworthiness when determining a loan’s interest rate. Since the 2014 CRL report did not consider the creditworthiness of the borrower, it is statistically meaningless.

Comparisons of credit are only statistically valid if borrowers are similarly situated (i.e., apples to apples). CRL instead cherry-picked minority respondents who (1) had, according to the report, “poorer credit than whites,” (2) had lower incomes, (3) purchased a higher percentage of used cars, and (4) borrowed more on average than the non-minority respondents.¹⁰ When the minority respondents claimed to pay a higher interest rate, CRL ascribed the reason solely to discrimination, instead of the fact that borrowers with poor credit pay higher interest rates than borrowers with excellent credit because of the greater risk. In fact, CRL’s report itself acknowledged that its results “do not necessarily demonstrate discrimination.”¹¹

In another widely discredited study, entitled *Under the Hood*, CRL has also alleged that dealer-assisted financing “lead[s] to more expensive loans.” Yet CRL did not provide *any* evidence in their report that dealer-assisted financing is more expensive than auto financing available from banks or credit unions.¹² In fact, what evidence exists shows that APRs are lower in indirect auto loans than in direct auto loans

⁹ The original version of the chart that was circulated by the Subcommittee omitted important introductory material that appears on the version of the chart posted on the NCLC website. That introductory material confirms that the data included is “from the late 1990s to early 2000s.” https://www.nclc.org/images/pdf/car_sales/tb-auto-dealers-racial-disparities.pdf The Subcommittee’s memo was later corrected and confirms that the entire chart ONLY depicts data from the era before caps on dealer compensation were imposed – and thus is not relevant to today’s market.

¹⁰ Center for Responsible Lending, “*Non-Negotiable*” (Jan. 23, 2014) at 8, 9.

¹¹ *Id.* at 9.

¹² A point-by-point rebuttal of the *Under the Hood* report can be found [here](#).

for similarly situated borrowers.¹³ This is the case for many reasons, including that the costs of providing indirect financing are lower than those of direct lending and that a dealer's access to many lenders vying to provide financing to consumers often provides car buyers with better finance rates than they could get on their own. It should be noted that CRL is an organization "closely affiliated"¹⁴ with the Self-Help Credit Union, an auto lender that directly competes with auto dealers.

A study by the National Fair Housing Alliance attempts to draw similarly unsubstantiated conclusions from sixteen cherry-picked auto shopping interactions, not from completed sales transactions. In a market with 17 million new sales annually, sixteen shopping transactions is such an insignificant sample size that the "study" is deprived of any statistically relevant significance. Also, the methodology of the study is not sufficiently explained to warrant specific conclusions about the price of financing. Furthermore, in several of the matched pairs transactions, the white testers would have paid more than the non-white testers, thus further eroding the study's value as evidence of widespread discrimination. Finally, the study did not use identically situated test subjects with debt to income ratios, incomes, etc.¹⁵

NCLC research also criticizes vehicle products such as service contracts and GAP (guaranteed asset protection) insurance but all the claims in the study are based on the review of data from ONE provider in the industry in 2012, as their footnote in Appendix B notes. Also, the NCLC alleges that these products are sold as mandatory products when in fact these products are voluntary. For these products to be included in the amount financed on a retail installment contract, the cost of the products must be separately stated in the contract and the consumer must separately consent to purchase the product. Lastly, this NCLC study has never been peer reviewed and the underlying data has never been released.

Finally, even some of the methods employed by the government need to be carefully reviewed. In issuing its 2013 guidance, the CFPB used a flawed method for identifying the background of consumers since their analysis was based solely on a borrower's zip code and last name.¹⁶

The Bayesian Improved Surname Geocoding (BISG) proxy methodology was designed to identify the backgrounds of specific populations, not to ascertain the specific background of an individual.¹⁷ A non-partisan study by Charles Rivers Associates of the CFPB's use of the methodology found a 41% error rate for classifying the background of a significant group of consumers. As noted above, even the CFPB's own review of its analysis revealed a 20% error rate for the same group.¹⁸ Additionally, the

¹³ NADA Comments to Federal Trade Commission re: Motor Vehicle Roundtables, Appendix A (Mar. 30, 2012), available at https://www.ftc.gov/sites/default/files/documents/public_comments/public-roundtables-protecting-consumers-sale-and-leasing-motor-vehicles-project-no-p104811-00105/00105-82872.pdf.

¹⁴ Center for Responsible Lending, "Non-Negotiable" Jan. 2014, p. 31.

¹⁵ A correct fair lending analysis must identify and compare similarly situated consumers by holding constant variables such as the amount financed; trade-in value; competition in the local market; market conditions; demand and desirability for the vehicle; the consumer's payment capacity; and whether the car is new or used.

¹⁶ Under previous leadership, the CFPB failed for three years to provide Congress policy analysis and answer direct questions to substantiate the guidance. Despite receiving 13 letters from Congress, signed by over 90 bipartisan Members and Senators, the Bureau never explained their analysis supporting the elimination of consumer discounts or fully answered fundamental questions raised by Congress.

¹⁷ <https://www.latimes.com/business/la-fi-rand-elliott-20160824-snap-story.html>.

¹⁸ *Using publicly available information to proxy for unidentified race and ethnicity: A methodology and assessment* (2014), Table 10. https://files.consumerfinance.gov/f/201409_cfpb_report_proxy-methodology.pdf.

Charles River study revealed that CFPB's analysis was "conceptually flawed and subject to significant bias and estimation error."

The study noted that for a correct fair lending analysis, the CFPB must ensure the consumers compared are similarly situated by holding key variables constant, including the following: (1) the amount financed; (2) trade-in value; (3) competition in the local market; (4) market conditions; (5) demand and desirability for the vehicle; (6) consumer's payment capacity; and (7) whether the car is new or used. Also, manufacturers provide dealers sales incentives that can operate to motivate a dealer to arrange financing a car at a discount or loss in order to achieve certain sales goals. If this factor is present, it must be taken into consideration as a dealer often has a vested interest in selling the car at a financing discount both to make the sale and to create customer loyalty that results in return business for parts, service, and future car purchases.

The Charles River study found that the CFPB's findings of variations in interest rates were significantly overstated and failed to consider legitimate and lawful factors, such as budget constraints and competing offers, which explain why a dealer may discount an interest rate and why prices vary from consumer to consumer.¹⁹ Especially in the context of this hearing, it is important to note that a rebuttal of the comprehensive Charles River study has never issued. See also *Fair Credit for Auto Loans: Too Important to Get Wrong*.²⁰

Why then did Ally Bank settle with the Department of Justice and the CFPB, when the CFPB was using a flawed methodology for identifying the background of consumers? Unfortunately, Ally could not rebut the CFPB's assertions because the Bureau refused to inform Ally how it had calculated fair lending bias.²¹

Additionally, the CFPB is a powerful regulator with tremendous leverage over lenders, and but for several factors, which were unrelated to the auto lending issue, it is unclear whether Ally Bank would have settled with the CFPB:

According to Ally's then-CEO, Ally was motivated to settle with the CFPB because of "...a desire to get the consent order behind it so it could move forward on other urgent business."²² That urgent business included getting the Federal Reserve Board to approve Ally's application to become a financial holding company, enabling Ally to continue offering insurance products and services that Ally might have been forced to discontinue. According to the *Wall Street Journal*, "Standard & Poor's Ratings Services... warned it would potentially lower the company's ratings if it failed to secure financial holding company status."²³ Ally's application was approved three days after Ally signed the consent order, and "the CFPB was one of a number of regulators that had input on the Federal Reserve's decision on financial holding

¹⁹ Charles River Associates, *Fair Lending: Implications for the Indirect Auto Finance Market* at 4 (Nov. 2014).

²⁰ *Infographic: Fair Credit for Auto Loans: Too Important for the CFPB to Get Wrong* (2017).

company status.”²⁴

Ally Bank was also motivated to settle because of its impending initial public offering. CFPB was aware of this fact, as the federal government owned 64 percent controlling interest in Ally Bank at the time. The then-CEO of Ally Bank told the press, “[n]o investor publicly was going to invest in us unless we got financial holding company status. And we could not do that without coming to terms with the CFPB.”²⁵ On March 27, 2013, Ally announced an IPO where the U.S. government “would sell the bulk of its stake in the company.”²⁶

Conclusion

We end our comments to the Subcommittee where we began. In addition to analytical points we have raised, NADA would like to reiterate its strong commitment to fair credit. And we not only publicly state our position, we proactively provide our members with the tools they need to help implement this approach. From our Fair Credit Compliance Policy and Program to our extensive training and educational offerings to our recently released Voluntary Protection Products Policy and Program, NADA stands ready to help ensure that the vehicle financing market both addresses fair credit concerns and retains the flexibility needed to ensure that consumers can get competitively-priced, affordable credit.

NADA looks forward to working with the Subcommittee to keep auto financing competitive and to assist consumers and their families as they seek affordable transportation.

Attachments:

NADA: Our Commitment to Fair Credit

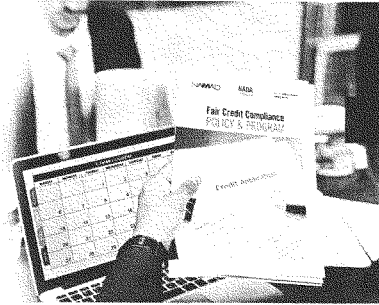
Fair Credit for Auto Loans: Too Important to Get Wrong



NATIONAL AUTOMOBILE DEALERS ASSOCIATION
Visit nada.org to learn more

Our Commitment to Fair Credit

by PETER WELCH, NADA



In today's market, America's new car and truck dealerships sell around 50,000 new cars and trucks a day. Consumer access to affordable credit at dealerships, and interest rate discounts that local dealerships can provide their customers, are keys to driving those sales. Congress recently repealed a lending guidance issued by the federal Consumer Financial Protection Bureau (CFPB) that threatened to adversely affect dealer competition and consumers' access to interest rate discounts. The guidance was repealed because of serious agency process concerns, and because it inadequately recognized that dealerships can provide competitive credit while fully adhering to our nation's fair credit laws. NADA is firmly committed to helping dealerships achieve both key objectives.

Adherence to non-discriminatory access to credit remains a core value for America's new car and truck dealers. Simply put, the CFPB guidance is gone, but the anti-discrimination laws governing lending, like the Equal Credit Opportunity Act (ECOA), are not. The fair credit laws that govern dealer conduct remain part of the fabric of the law. Beyond the law, those statutes underscore a moral imperative to avoid discrimination and to treat all customers fairly and with respect.

Four and a half years ago, based on our twin commitments to competitive credit and fair lending, NADA partnered with the American International Automobile Dealers Association (AIADA) and the National Association of Minority Automobile Dealers (NAMAD) on a simple but incredibly important initiative. We sought to develop a compliance framework, available to all dealers on a voluntary basis, that enhances the ability of participating dealers to comply with

our nation's fair credit laws while retaining the flexibility needed to meet the borrowing needs of the nation's car buyers.

Recognizing the need to promote these important goals, we re-examined a crucial question: Can fair lending compliance and consumer interest rate discounts coexist? Fortunately, the U.S. Department of Justice (DOJ), which had also been considering the issue for a long period of time, clearly determined that the answer was "yes."

Building on that conclusion, we developed a program that promotes compliance by better structuring the exemption-based discounting system that has long been the hallmark of an ECOA-compliant indirect auto financing market. The improved approach was designed to ensure that discounting remained possible but only in ways that assured that similarly situated people were treated the same,

PERCENTAGE OF VEHICLES WITH FINANCING
In 2017, 85.1% of new-vehicle buyers and 53.8% of used-vehicle buyers financed their purchases.



TOTAL U.S. AUTO LOAN BALANCE
(2013-2017)



MARKET SHARE OF TOTAL FINANCING
(new/used units and loan/lease)



Peter Welch is President & CEO of the National Automobile Dealers Association.

Learn more at nada.org/faircredit



NATIONAL AUTOMOBILE DEALERS ASSOCIATION
Visit nada.org to learn more

regardless of race, national origin, religion, sex, age, or other protected characteristics.

How did we come up with this framework for maintaining fair credit compliance while preserving discounting? We didn't—the DOJ did.

In 2007, the DOJ entered into consent orders with two dealerships to resolve allegations of fair credit violations. These allegations were remarkably similar to the more recent ones brought against indirect finance sources by the CFPB.

Importantly, these DOJ consent orders did not eliminate either dealer participation or a dealer's ability to offer discounts. Instead, to permit consumers to continue receiving the tremendous benefits of discounting, the consent orders required the dealers to standardize the initial amount of dealer participation included in all retail installment sale contracts, and allowed deviations from that standard amount only in the presence of a legitimate business justification, such as a competing credit offer from another lender or a monthly budget constraint on the part of the customer.

It was a well-balanced and effective solution. Which is exactly why the NADA/AIADA/NAMAD Fair Credit Compliance Policy and Program (the Program) further operationalizes the DOJ framework and makes it available to all dealers. Just like the DOJ consent orders, the Program's approach takes race and other protected characteristics out of the equation entirely; it calls for a dealer who adopts the Program to standardize the amount of dealer participation for every customer, and only allows that dealer to deviate in one direction (downward), and only in response to a legitimate business reason—like marking down a rate to meet a competing offer or monthly budget constraint—that has nothing to do with race or any non-business factor.

NADA believes the Program represents the best approach to promote compliance with ECOA while preserving enough flexibility to allow customers to continue leveraging the overwhelming benefits that are produced by today's intensely competitive vehicle financing market. Dealerships that implement the Program reduce their discrimination liability risks under ECOA, and it is also unquestionably the right thing to do. Treating customers in a fair and consistent manner and strictly abiding by all anti-discrimination laws are central to the mission and success of franchised auto dealers everywhere. The Program reflects an unambiguous commitment to both of these principles.

For these reasons, much of our focus is on making the Program even easier to implement through partnerships with providers such as CU Direct, Dealertrack, and RouteOne. Thanks to these arrangements, the Program can easily be integrated into the F&I operations of participating dealerships, as well as automated. I am confident that we will see additional progress on this front in the coming months.

As long as I am President and CEO of NADA, I will continue to encourage every franchised dealer and dealership group to adopt and implement our Program. I will also continue to seek additional bipartisan support among federal policymakers—regardless of which party is in power—and encourage them to embrace the Program as the best way to ensure fair credit compliance in auto financing.

In the meantime, it is up to our industry to lead the way. We have at our disposal a way to affirm our commitment to abide by some of our nation's most important laws while doing right by our customers. That's a commitment that every dealer should be proud to get behind. ■

FAIR CREDIT FOR AUTO LOANS

TOO IMPORTANT FOR THE CFPB TO GET WRONG

The CFPB's fair credit initiative to eliminate or limit a dealer's ability to discount auto loans for consumers has several fundamental flaws, including three major problems:

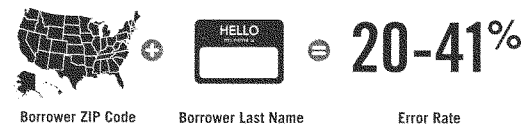
- 1 The CFPB is using an analysis for determining the background of borrowers it knows to be flawed.
- 2 Its analysis does not compare customers that are similarly situated (alike in relevant ways).
- 3 It fails to account for legitimate, competitive business factors that may explain pricing differences.

PROBLEM 1:

The CFPB's Consumer Analysis is Flawed

To evaluate whether dealer discounts for consumer auto loans adversely affects one group relative to another even when consistently applied, an analysis must first determine who is a member of a protected class (such as race, national origin, etc.). To determine a borrower's background, the CFPB relies on a method that: (1) was not designed to determine the background of individual borrowers; and (2) it knows to be flawed.

Flawed CFPB Method



A non-partisan study by Charles River Associates found a 41 percent error rate for classifying a significant group of minority consumers. The CFPB's own review revealed a 20 percent error rate for the same group.



PROBLEM 2:

Analysis Fails to Compare Customers that are Similarly Situated

A proper fair credit examination must ensure that consumers being compared are both appropriately classified as belonging to a protected group (based on race, national origin, etc.) and that those consumers are similarly situated. For example, the CFPB does not compare customers that are alike in relevant ways since it does not take into account factors not related to a consumer's background that may impact loan rates, such as whether a consumer is buying a new or used car or different geographic markets.

Proper Method

Belonging to a protected group (based on race, national origin, etc.)



Alike in relevant ways (similarly situated)

PROBLEM 3:

The CFPB Fails to Look at Legitimate Business Reasons

Even if the CFPB accurately classifies the background of a borrower, and then does an "apples to apples" comparison of borrowers, the Bureau would still need to take into account "legitimate business reasons" for any pricing differentials. In 2007, the Department of Justice recognized seven legitimate business reasons for dealers discounting auto loans, such as to meet a consumer's monthly budget, or when a dealer "meets or beats" competing offers from a bank, credit union or other dealer. The CFPB, however, fails to account for legitimate, competitive business factors that may explain pricing differences.



Monthly Budget



Competing Offer from Lender



Reduced Rate for Consumer

CONGRESS SHOULD HELP RESOLVE THIS IMPORTANT ISSUE

- Every consumer deserves to be treated fairly.
- The retail automobile industry has promoted a strong fair credit compliance program based entirely on the Department of Justice approach manages fair credit risk, and explains any pricing differences. The CFPB should embrace a DOJ-based program that addresses fair credit risk while preserving consumer discounts that keep auto credit affordable.
- It's important that government agencies follow due process and employ an independent and unbiased analysis, especially when dealing with such important issues of fair credit and consumer affordability.
- Congressional assistance is needed to bring this matter to a successful conclusion and to preserve consumers' access to affordable auto credit.

March 10, 2017