Consumer Finance Monitor (Season 4, Episode 41): Hot Issues in Auto Finance

Speakers: Chris Willis and Stefanie Jackman

Chris Willis:

Welcome to the Consumer Finance Monitor podcast, where we explore important new developments in the world of consumer financial services, and what they mean for your business, your customers, and the industry. I'm your host, Chris Willis, the co-practice leader of Ballard Spahr's consumer financial services group, and I'll be moderating today's program. For those of you who want even more information, don't forget about our blog, consumerfinancemonitor.com. We've hosted the blog since 2011, so there's a lot of relevant industry content there. We also regularly host webinars on subjects of interest to those of us in the industry, so to subscribe to our blog, or to get on the list for our webinars, just visit us at ballardspahr.com. And if you like our podcast, let us know. Leave us a review on Apple Podcasts, Google, or wherever you get your podcasts.

Chris Willis:

Today, I'm joined by my partner, Stefanie Jackman, who is in our Atlanta office. She and I do a lot of work in the auto finance industry, and that in fact is what we're going to be talking about today, recent hot issues relating to auto finance, so Stefanie, welcome to the podcast.

Stefanie Jackman:

Thank you for having me, Chris, great to be here.

Chris Willis:

So we're going to run through a handful of sort of hot issues dealing with auto finance today, and the first one that I wanted to talk about seems like one that just keeps coming up, and that is fair lending, and in particular, the first fair lending issue that I wanted to highlight for our listeners was the issue of dealer finance charge participation. Now, we've already had two successive rounds of this issue come to visit the industry. The first one started in the late 1990s with a series of class action lawsuits, mostly litigated in the Middle District of Tennessee. Those got settled, and then the issue went quiet for a while. Then the CFPB was formed, and between 2013 and 2016, the CFPB entered into a number of consent orders with a number of auto finance industry players, dealing with the alleged discriminatory effect of allowing dealers to negotiate retail interest rates with consumers over and above the indirect auto finance company's buy rate.

Chris Willis:

And then that went quiet in 2016 or '17, and then subsequently of course the CFPB's bulletin, on which its theory was based, was invalidated by the Congressional Review Act during the Trump administration, so the issue then went quiet. But in 2018, the New York Department of Financial Services essentially adopted word for word the invalidated CFPB bulletin, and stated that it was going to make this dealer finance charge participation issue a priority.

Chris Willis:

We didn't hear anything about it for another couple of years, but then just recently, within the past couple of months, the New York Department of Financial Services entered into consent orders with two small banks in Upstate New York, one of which wasn't even in the auto finance business anymore, and the other one was still in, and those consent orders are notable in two ways. First of all, the allegations, the alleged violations, the legal theory, are all nearly identical to what we had seen from the CFPB consent orders from 2013 to '16, so in that regard, they're really the same, but where they part company with the CFPB was on the remedy.

Chris Willis:

The CFPB's consent orders with various banks and captives didn't require flat-fee pricing for dealers, they allowed sort of a standard level of markup, but there were opportunities to deviate from that based on certain consumer circumstances, like a competitive offer, for example. But the New York DFS consent orders with these two banks, again, one of which isn't even in the industry anymore, just say, "You must compensate the dealers on a flat-fee basis, period, end of story."

Chris Willis:

And so I think the industry is sitting there looking at that, saying, "Well, is that the law in New York now? Is that something that everybody's expected to do?" And the problem with that as a conclusion is that there is an incredibly strong market force that is the dealer's market power, that makes it very difficult for indirect auto finance sources to just adopt flat fees, particularly unilaterally, because the first to comply with a directive like that, if it is in fact a directive, is really the first loser in terms of business volume, and we saw that very graphically with some industry players who rushed after the CFPB's consent order to adopt flat fees, and then promptly, according to industry data, lost 70%, 80%, 90% of their market share.

Chris Willis:

And so the industry's learned that lesson I think, and so the CFPB's efforts to change the dealer finance charge participation industry practice ultimately didn't work, because the market forces were just too strong, and now New York DFS is having a go at it, so we're going to have to be watching with interest to see what happens with respect to that, and we'll just stay tuned for that. So far, it's just two consent orders with two small banks in Upstate New York, we'll see what happens if the New York DFS applies this to someone who has a greater financial need to resist the conclusion that's in these consent orders.

Chris Willis:

The other thing that I wanted to point out is, on the CFPB front, even though there's not been any indication yet of the bureau picking back up with the dealer finance charge issue, we definitely expect CFPB attention on other fair lending issues in auto finance, and in particular the easiest one to predict would be judgmental underwriting and pricing, to the extent it exists, and some auto finance companies do a lot of that, and the related issue of judgmental sort of exceptions or tier-bumpings, trying to make deals work usually at the request of dealers.

Chris Willis:

Whenever you have a judgmental or exception process like that, it's always been a magnet for fair lending analysis by all the regulators, the CFPB included, and those practices still exist to a pretty significant extent in the auto finance industry, so it's pretty easy to predict that there'll be a lot of fair lending scrutiny in those areas. But Stefanie, what about some of the newer areas? What can we expect by virtue of the fact that we have kind of a new CFPB with new leadership now?

Stefanie Jackman:

It's a great question, Chris, and I think about the fact that we just saw the Senate confirm now Director, not nominee, Rohit Chopra, who has a background in fair lending, exactly in that area. He also has made statements in the past about that being an area where he thinks attention and regulatory oversight is appropriate.

Stefanie Jackman:

Coming into his directorship, the acting director, Director Uejio, who was at the helm, made lots of statements, if you remember earlier this year, about the importance of focusing on fair treatment, fair lending, areas of discretion, to make sure consumers are treated appropriately, and I think that that was further heightened as we were working to emerge from the pandemic, which in some instances, is still happening and consumers had experienced different challenges in coming through that financially and in other ways, so how are they accommodated? How are you helping them come out of that accommodation? What are you doing to ensure it's successful? And that fits very neatly in a fair lending rubric, except it's not lending, of course, right?

Stefanie Jackman:

But to your point, Chris, it's an area where there can be a lot of judgment. There can be requests for exceptions, there can be a need for some flexibility to accommodate consumers, to actually help them, but you need to, I think, be attentive to see are different populations being impacted in different ways or not? Because I think the CFPB will look at that. What the challenge is, in fair lending, okay, we have some metrics, particularly in mortgage, things that we can use, we... You've already mentioned whether we'll see it come back in the auto lending context in the way that the CFPB had tried to do previously, but has since been walked back and withdrawn.

Stefanie Jackman:

Maybe they'll make a go at it on the servicing collection side under the guise of pandemic recovery and helping consumers, and through a softer UDAP lens, but the same sort of, "Are people in this group versus this group fairing better or worse as they emerge?" I think there's definitely precedent for them doing that, and in fact, I seem to recall there have been a couple of reports coming out from the CFPB recently about consumers from more depressed demographic areas having higher rates of complaints, people in different groups experiencing different types of challenges coming out of the pandemic. There's usually statements about reminding that working with consumers and applying policies and approaches even-handedly and evenly is important, so I kind of feel like it's only a matter of time until they find something in that area, and it could be the place that we see fair treatment reemerge with the new CFPB. I don't know if you... What your thoughts are, what you're seeing?

Chris Willis:

I think there's a lot of desire within the bureau to look at these kinds of servicing and collection, and particularly loss mitigation and hardship options, through a fair lending lens, and I feel like if it's ever going to happen, now's the time, because you have the combination of the new leadership of the bureau, their very intense interest in racial justice and equity, and the... We're emerging from the pandemic as further reasoning behind it, so it feels to me like the stars are aligned for it to happen, we'll just have to wait and see if it actually eventuates.

Chris Willis:

So let's shift gears, Stefanie, for a second about something else that's very important to the auto finance industry, and that is ancillary products, and it's been an area of significant consumer group criticism, but so far, kind of limited regulatory activity, so where are we, and where do you think we're going to be on ancillary products in the auto finance area?

Stefanie Jackman:

Well, it is an ongoing focus of the CFPB, both in exams and in enforcement actions. It is not an area they have forgotten about, it is not an area that they're not interested in, it is something that they ask about. We saw them asking about it in the horizontal information request last summer, and then... Well, when I say "Last summer," I mean 2020 summer, as well as 2021 summer.

Stefanie Jackman:

We know just through the grapevine that it is an area of inquiry, including currently, so this is a place where I think the CFPB has and continues to gather information, examine practices, work to understand on both sides of the product, both in how it is marketed and presented to a customer, as well as how it is ultimately realized, utilized, refunded, and I fully expect to see attention being paid to ancillary products, vehicle service agreements, GAP insurance, et cetera, and I think the CFPB will be looking, as they have, aggressively at how are these marketed, what are the promises that are made at the front end? And then looking for data to dovetail that whatever you're saying it does is actually something that consumers on the backend are getting.

Stefanie Jackman:

So if you're saying that, for instance, this particular product will give you peace of mind here, how many consumers are actually utilizing it? Is it assisting them? Or are very few consumers taking advantage of these products that they've purchased? Do they understand these to be mandatory or not, voluntary or not? Do they understand them to be something they don't have to finance, or could finance?

Stefanie Jackman:

And I also think the CFPB is very likely to continue to push where we've already seen them going over the years through consent orders, but maybe even more so, behind the scenes in exams, that they see this as your responsibility as the lender, or if you're in a servicer capacity, you're not maybe the lender, to ensure that these products that your customers have obtained, that likely aren't even your products, that they are being made aware of the fact that they may be entitled to a refund, that they may be entitled to certain credits to the account, and I think it's a place where the CFPB could... I think back to when they sort of evolved, through a consent order, how we identify service members. I could see that happening here under the current leadership.

Chris Willis:

So, there's been another recent development on ancillary products that I want to talk to the audience about, but this one comes from a state regulator, actually the Massachusetts attorney general, and that office has done a lot of enforcement, particularly in subprime auto finance, over the past few years. And they just released another resolution, a consent order or an AOD, I forget which it was, with a subprime auto finance company that they'd been litigating with for several years, and there's an interesting provision in there about vehicle service contracts.

Chris Willis:

So under the consent order, this subprime auto finance company is required to have the consumer receive and sign a standalone document that has disclosures about the vehicle service contract. The disclosure has to say that it's optional, to your point a moment ago Stefanie, and it has to identify the amount by which buying that product will increase the amount financed on the retail installment contract, so the... It has to have that in order to finance a vehicle service contract.

Chris Willis:

In addition, after the indirect auto finance company buys the contract and onboards it, it is required under the consent order to send a post-acquisition notice to the customer, basically saying, "We see you have a vehicle service contract. If you want to cancel it and get a full refund, here's how you do it," and giving them a pretty easy way to cancel it in full, for a full refund. And so that's a disclosure scheme that doesn't exist, that I'm aware of, widespread in the industry, it's not required by any specific state or federal law, and so one question that everybody I think is asking themselves in the indirect auto finance business is, "Is this going to be a requirement now under the Massachusetts UDAP law, Chapter 93A?"

Chris Willis:

And we have to wait and see what the Massachusetts attorney general says or does about that in future cases, but my own belief about it is, this was a litigated case with a lot of allegations dealing with vehicle service contracts, and so I would think of these disclosure forms that I just described as being definitely a best practice for the industry to adopt, but I don't feel yet that there's enough evidence for us to conclude that they're a hard requirement. So we'll see what happens with that, but that was a very notable recent development with respect to VSCs. Query, would it also apply to other ancillary products, like GAP? The consent order doesn't, it only applies to vehicle service contracts, but I think there's not a lot of basis for distinguishing between them on a basis like this.

Chris Willis:

But Stefanie, do you have any other sort of more general comments about that recent consent order from Massachusetts?

Stefanie Jackman:

Yeah, just one thing picking up on what you just said about the form, and that while we're not thinking this is going to necessarily become the norm, one of the things I've seen watching the servicing collection space over the years is that sometimes, as states enact things like this and companies are having to comply one way or another, has a way of say, spreading, right? Across industry, or getting regulators to say, when you say, "Well, I can't think of a way to do this better," they'll point to it as an example of one where you can do it differently, and in their view, better.

Stefanie Jackman:

So I think it's also just something to watch to see if it gets traction with other states, or if it's something that you start hearing maybe in an exam, or just questions about it, because as you know, Chris, these types of things have a way of jumping. I think it's going to be a real impact of... New York City, for instance, the LEP things that they put into place last summer, and people are having to comply with.

Stefanie Jackman:

But some other things that were important with the CAC consent order that I noticed is on the servicing side, the Massachusetts attorney general wants the call caps complied with. So if you know the Massachusetts collection laws, they have two separate statutes, one that applies to creditors and arguably others, and is enforced by the attorney general, and then one that is just third-party collection licensees, and has a different regulator at the helm, and we sometimes see conflicts there.

Stefanie Jackman:

But both laws cap the amount of times that you can attempt to call a consumer, and the Massachusetts attorney general made very clear that those call caps apply, and that those call caps are actually more stringent than what Reg F is imposing. So I spend a lot of time with first-party and creditors talking about how should we think about the call caps in Regulation F, and one of the things I'm always careful to remind them of is, "Well, Regulation F may not apply to you because you're not subject to the Fair Debt Collection Practices Act. Maybe you want to try to align for UDAP reasons, but there are state laws like Massachusetts', often one I cite, that impose those kinds of caps on you already." So this consent order just highlights, that's not something that's just there that Massachusetts doesn't realize and enforce. It was a big part of the consent order.

Stefanie Jackman:

They're also requiring that repossession notices... This is an area, Chris, I know that we've talked about in the past, and there's been a lot of attention, and continues to be at the federal and state level, on repossession activities, and ensuring that you are sending the notices that are required in accordance with state law, and that was another point here, of making sure that pre and post-sale repossession notices are being sent, that they are reflecting the fair market value of the vehicle that is being used to calculate any deficiency balance, if you're seeking a deficiency balance, and having to send those communications to your customers, and there's not a lot of room for variance and creativity, at least in Massachusetts, with that law.

Stefanie Jackman:

And then there's also in there a continuing attention to credit reporting, so for the impacted consumers, there have to be tradeline solutions. That can be difficult to manage, that always gets attention, and it has impacts, so I see it as very significant. And then just stepping back from the consent order itself, the reason I see it as very significant is Massachusetts is very active right now. It has been for some time, and it hasn't slowed down. I remember back when we had the shift away from the Cordray CFPB to Director Mulvaney, wondering if states would be able to keep up, right? Would they be able to fill what people perceived to be an enforcement void? And I think that Massachusetts and others have proven they absolutely can.

Stefanie Jackman:

Massachusetts recently put out another consent order, again imposing and reminding creditors and first-party that we have collection laws that have requirements, like a validation notice, another thing you're not accustomed to thinking of, saying you

have to comply with that, and the failure to do that resulted in a fairly large penalty. So Massachusetts isn't alone, but it continues to really push the envelope. We saw it do it during the COVID pandemic too, Massachusetts had... Their law was actually challenged, with one of the more aggressive collection-related restrictions during that period of time. So I continue to look to Massachusetts in the area of auto lending, auto servicing and collections, and a variety of other areas, as a state that is high on the list of ones to watch with risk.

Chris Willis:

Yeah, for sure, there's no question that you're correct about that assessment. There's one final thing that I wanted to tell the audience about with respect to auto finance, and it was a recent CFPB research report, a data point is what they call it, and they come out with these from time to time in various industries, but this one was about subprime auto finance, and the central theme of this data point was that the bureau had done an analysis of subprime auto finance companies who finance their vehicles through several channels, through banks and credit unions, from captives, from independent subprime large and small auto finance companies, and from large and small buy here, pay here dealers, which of course are dealers that have their own financing arm, or their own financing capability.

Chris Willis:

And the central question that the CFPB was trying to answer is, do people who go through those different channels pay different interest rates? Which they do, according to the data that the CFPB looked at, some of those channels are more expensive from an interest rate standpoint than others, with predictably banks and credit unions being the least expensive, and buy here, pay here being the most. But then they said, "Well, can we explain those differences in interest rates solely by creditworthiness?" Because they had some creditworthiness information about the consumers involved. And the answer was yes, somewhat, but not entirely.

Chris Willis:

And so the bureau's sort of bottom-line conclusion was, "We need to do some more research on why, what are the other reasons for these pricing differences between channels?" But the theme seems to be that there are some customers who might fit the creditworthiness bucket for a number of these different types of auto finance sources, banks and credit unions, captives, independent subprimes, or buy here, pay heres, and that the same person might pay a higher interest rate depending on where they go, so to speak.

Chris Willis:

And so that was the basic thrust of the CFPB's data point. To me, it's a matter of mostly either academic or policy interest, because if that conclusion is true, let's say the CFPB's exactly right and that the same person could walk into a dealer and do an indirect auto finance deal with an independent subprime, versus they could walk in and buy the same car from a buy here, pay here, and they'd end up paying a higher interest rate at one versus the other, that doesn't really indicate any wrongful conduct by either of the finance sources. They're each doing their own thing, they don't consult with one another on pricing, let's hope, and so to me, the report doesn't seem to be a prelude or an overture to some kind of enforcement initiative, it seems to be of sort of research or academic interest about the functioning of the auto finance industry in general, so I don't... I'm not expecting any particular enforcement focus to flow out of the report, but we'll see.

Chris Willis:

That's sort of the last thing that Stefanie and I wanted to tell you about on today's podcast, so Stefanie, thanks very much for joining us on the podcast today, thanks for sharing your insight and experience in auto finance, which is very considerable, and thank you to our audience for listening. Be sure to visit us at our website, ballardspahr.com, where you can subscribe to the podcast in Apple Podcasts, Google, Spotify, or whatever your favorite podcast platform is. And again, don't forget to check out our blog, consumerfinancemonitor.com, for daily insights about the financial services industry. And if you have any questions or suggestions about the podcast, please email us at podcast@ballardspahr.com. Stay tuned each Thursday for a great new episode, and we'll see you next week. Thank you all for listening.