Dealer Finance Charge Participation in the Indirect Auto Finance Market: What the Statistics Really Show

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What Are We Trying to Measure?

• The question is whether auto dealers’ ability to negotiate the retail rates of their own agreements with customers results in a disparate impact.

• How do we know which customers belong to which racial or ethnic group?

• How do we analyze the dealers’ transactions?

• Do we explore legitimate, non-discriminatory explanations for the results of those transactions?
The BISG Proxy Method

- Uses a combination of a person’s last name and residential address to predict race / ethnicity
- But doing this causes errors in identification, and those errors are not random.
- The BISG method systematically treats African-American and Hispanic consumers who live in more affluent areas as being non-Hispanic white.
- By conflating race/ethnicity with affluence, the proxy method creates and magnifies an appearance of discrimination that runs along race/ethnicity lines, but in reality more closely corresponds to affluence.
- This error creates very large errors in estimating pricing disparities: 87% for African-Americans; 57% for Hispanics.

Portfolio Analysis

• The CFPB’s approach was to look at an auto finance company’s portfolio as a whole.
• This portfolio analysis, however, undermines the credibility of the entire finding of disparate impact.
• The portfolio analysis is flawed because it is based only on a portion of each dealer’s transactions that are assigned to a particular finance source.
• Moreover, a portfolio analysis can create an appearance of discrimination, even where none exists.
A Hypothetical Portfolio Analysis

Dealer 1:
Prices all contracts at buy rate +1% (100bps) with no exceptions

Dealer 2:
Prices all contracts at buy rate + 1.5% (150bps) with no exceptions

• A dealer-level analysis will show that neither dealer has engaged in any discrimination.
• But if there is a difference in the racial/ethnic makeup of the dealers’ customers, then a portfolio analysis will show that there is disparate impact on the basis of race/ethnicity.
Ignoring Non-Discriminatory Factors

• There are legitimate reasons why a dealer may vary the margin between the buy rate and the retail rate.
• The Department of Justice recognized seven such factors in the Pacifico and Springfield cases.
• The CFPB’s analysis of indirect auto finance failed to include any analysis of these factors.
• Including these factors in an analysis radically reduces the “disparities.”
Non-Discriminatory Factors

• **Credit score range**: consumers with higher credit scores have more available credit options, and have access to more competitive offers. *This is true even within individual race/ethnicity groups.*

• **Deal-specific factors** like new/used vehicles and length of term: finance sources frequently have different policies in terms of pricing with respect to different types of transactions.

• **State of transaction**: different states have different regulations relating to consumer credit transactions, and different local competitive environments.
Impact of These Factors

• Correcting for BISG errors and including just a few simple controls that are visible in the data reduces the appearance of discrimination to a very small level (6-9bps), well within the error rate of the analysis.

• Other factors legitimately affecting price are not visible in an analysis, like a consumer’s monthly payment constraint.

What Does the Data Tell Us?

• The appearance of disparate impact in the pricing of auto finance contracts has been significantly distorted by the selection of the analytical method.

• Using an analytical method that is more accurate and takes into account the real-world aspects of auto finance transactions, the appearance of a discriminatory impact is smaller than the degree of precision inherent in the model.

• The premise that there is a problem of disparate impact that needs to be addressed is, quite simply, false.