Ballard Spahr LLP

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

Maryland Financial Consumer Protection Commission

November 16, 2018

Christopher J. Willis
Practice Group Leader, Consumer Financial Services Litigation
678.420.9436
willisc@ballardspahr.com

Ballard Spahr LLP

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.

Source: A. Baines and M. Courchane, *Fair Lending: Implications for the Indirect Auto Market* (2014).

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:	Dealer 2:
Prices all contracts at buy rate +1% (100bps) with no exceptions	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.

Source: A. Baines and M. Courchane, *Fair Lending: Implications for the Indirect Auto Market* (2014).

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.