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Consumer Financial Protection Bureau ALERT

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MARCH 2013

CFPB Targets Fair Lending in Auto Loans

Taking another step closer to bringing enforcement actions over allegedly discriminatory auto loans and interest rate markups by auto dealers, the Consumer Financial Protection Bureau (CFPB) reportedly has sent warning letters to at least four banks, advising that they could be targets in such actions. These warning letters, reportedly issued Feb. 21, purportedly gave the unidentified lenders only 15 days to provide the bureau with an explanation of their practices.

The Dodd-Frank Act of 2010 granted the CFPB authority to supervise many of the participants in the auto lending industry. Under a hard-won exemption in the Dodd-Frank Act, most auto dealers are expressly exempted from the CFPB's supervisory, rule-making and enforcement jurisdiction. This effectively forces the CFPB to look to other perceived participants in the auto loan sale and financing process in order to address dealer conduct that potentially violates federal consumer laws.

The CFPB does have jurisdiction over other participants in the auto lending industry, however, including very large banks (defined as those with assets of more than $10 billion) that either make auto loans directly to consumers or purchase installment contracts from dealers. The bureau has authority to supervise, make rules for and bring enforcement actions against these large banks. While the bureau does not have supervisory or enforcement authority over smaller banks, these institutions are still subject to the CFPB's regulations.

The bureau also has authority to regulate non-bank finance companies that either make direct vehicle financing loans to consumers or purchase dealer contracts, as well as enforcement jurisdiction under both the Dodd-Frank Act and the 1974 Equal Credit Opportunity Act. These non-bank auto lenders likely include in-house financing companies owned by the major auto manufacturers.

While fair lending practices have been a focus of the CFPB since its inception, to date the agency has not commenced any known enforcement actions, nor initiated any rule making, involving discriminatory lending issues. In April 2012 the bureau released guidance indicating that it would apply the "disparate impact" or "effects" test to consumer financial products, indicating that lenders could face enforcement actions not only for deliberate discrimination or disparate treatment of protected classes, but also for actions that have a discriminatory effect, even if the lenders did not intend to discriminate.

The CFPB's reported heightened scrutiny of the automotive financial industry is believed to relate to the industry practice of "dealer markups," through which dealers have discretion to charge consumers higher interest rates than are offered by lenders and to keep the spread. The CFPB reportedly believes that this practice may result in violations of the ECOA, which prohibits discriminatory lending.

The CFPB's procedures give the bureau discretion to issue advance notice of possible enforcement, providing subjects with an opportunity to respond before an enforcement action is initiated. This procedure is similar to the "Wells process" that is used by the U.S. Securities and Exchange

Commission. Neither the CFPB nor any banks have confirmed the issuance of warning letters.

If provided, the bureau's warnings are a second step in the CFPB's campaign against discriminatory auto lending practices, which began in 2012 when the bureau reportedly sent civil investigative demands to lenders and others involved in auto financing.

Although the warning letters apparently were sent only to large banks and not to smaller banks and finance companies, the selection of the banks as initial targets may arise from CFPB concerns about the current scope of its authority following a recent District of Columbia appellate court decision. If upheld on appeal, the ruling in Canning v. National Labor Relations Board, which found President Obama's "recess" appointments of three NLRB commissioners in early January 2012 to be "constitutionally invalid," would also effectively undermine the validity of the president's same-day, same-method appointment of CFPB director Richard Cordray.

Since the Dodd-Frank Act provides that certain of the CFPB's powers are not effective until its first director has been duly appointed by the president and confirmed by the Senate, a determination that the president's unconfirmed "recess" appointment of Cordray is invalid would substantially limit the bureau's powers, including its authority to supervise non-bank entities and to initiate enforcement actions. Challenges to the CFPB's authority on these grounds have already been raised in two pending lawsuits (see CFPB v. Chance Gordon Law Firm, No. CV-12-6147, C.D. Cal.; State Natl. Bank of Big Spring v. Geithner, No. 12-CV-1032, D.C.D.C.). Rather than expose itself to further challenges that might develop if the bureau were to move against other entities that might not be subject to its authority, the CFPB may have elected to proceed against only the large banks, authority over which was indisputably transferred by statute in July 2011.

Regardless of the validity of the director's appointment or the reasons for the CFPB's selection of the large banks as its initial targets, there can be no doubt that the bureau is continuing with its apparent plans to bring enforcement actions against entities involved in auto lending practices that the bureau believes have a disparate effect on protected classes of individuals. The window of opportunity for proactively addressing this issue is closing, as the CFPB moves toward announcing its first enforcement actions against banks and non-banks that allow dealer markups in connection with consumer auto loans. So now is the time to implement a litigation-readiness program to identify and address potential problems before the CFPB does. Click here for more information about litigation readiness.

For more information about the content of this alert, please contact Michael Mallow, Michael Thurman, Livia Kiser or Patrick Downes.

Loeb & Loeb LLP's Consumer Financial Protection Bureau Task Force

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