



Consumer Federation of America

Issue Brief

Auto Dealer Markups, Jim Crow Finance, and the Congressional Review Act: How Congress May Bend the Rules to Facilitate Overpriced and Discriminatory Auto Lending

Christopher L. Peterson

April 17, 2018

The Consumer Federation of America is an association of more than 250 nonprofit consumer groups that was established in 1968 to advance the consumer interest through research, advocacy and education.

Christopher L. Peterson is a Senior Fellow at the Consumer Federation of America and the John J. Flynn Professor of Law at the University of Utah's S.J. Quinney College of Law.

Executive Summary

In 2013 the Consumer Financial Protection Bureau (CFPB) released a guidance document that explained how “dealer markups” can violate the Equal Credit Opportunity Act when those markups have discriminatory effects on minority borrowers. The CFPB provided the guidance to assist financial companies on how to comply with existing law, not to create new requirements.

A “dealer markup” occurs when an auto dealership receives an undisclosed kickback from a lender in exchange for persuading the customer to agree to a higher interest rate than the borrower qualifies for with that lender. While dealer markups inflate the cost of purchasing vehicles for customers from many backgrounds, studies show that markups can be discriminatory because they may result in some minority groups paying higher interest rates on average than white borrowers with similar credit histories.

Instead of helping the CFPB promote fair and transparent auto finance, Congress is now considering resolutions under the Congressional Review Act that would invalidate the CFPB’s guidance on discriminatory auto dealer markups. These resolutions are a dangerous and unconventional use of the Congressional Review Act, which has never before been used to attack an agency’s guidance document that merely interprets existing law. In every past use of the Congressional Review Act, Congress used the Act to address a regulation issued through notice and comment rulemaking.

In this issue brief, the Consumer Federation of America:

- Calls on members of Congress to oppose S. J. Resolution 57 (Moran-KS) and H. J. Res. 132 (Zeldin-NY);
- Recommends prohibiting dealer markups that vary dealer compensation based on loan terms other than the amount financed; and,
- Advises consumers to protect themselves from dealer markups by shopping for auto finance in advance with a reputable credit union or bank instead of relying on the sales staff at an auto dealership.

Issue Brief

Background

In 2013, the Consumer Financial Protection Bureau (CFPB) issued guidance explaining why “dealer markups,” a specific auto lending practice, can be illegal under the Equal Credit Opportunity Act.¹ Dealer markups reward car dealerships for convincing customers to pay higher interest rates and finance charges than those for which they would otherwise qualify.² These profitable dealer interest rate markups give auto dealers the discretion to charge consumers different interest rates regardless of consumer creditworthiness. Unfortunately, empirical evidence suggests the dealer markups lead to some minority groups paying higher interest rates for car loans than similarly situated white borrowers.³

Now, congressional leaders are using an unprecedented procedure to roll back the CFPB’s guidance and allow car dealerships and auto finance lenders to continue taking

¹ *CFPB to Hold Auto Lenders Accountable for Illegal Discriminatory Markup*, CONSUMER FIN. PROTECTION BUREAU (Mar. 21, 2013), <https://www.consumerfinance.gov/about-us/newsroom/consumer-financial-protection-bureau-to-hold-auto-lenders-accountable-for-illegal-discriminatory-markup/>.

² *Fact Sheet, Consumer Financial Protection Bureau to Hold Auto Lenders Accountable for Illegal, Discriminatory Markup*, CONSUMER FIN. PROTECTION BUREAU (2013), https://files.consumerfinance.gov/f/201303_cfpb_march_Auto-Finance-Factsheet.pdf.

³ See NAT. FAIR HOUSING ALLIANCE, *DISCRIMINATION WHEN BUYING A CAR* (2018), <http://nationalfairhousing.org/wp-content/uploads/2018/01/Discrimination-When-Buying-a-Car-FINAL-1-11-2018.pdf>; NAT. CONSUMER L. CENTER, *AUTO ADD-ONS ADD UP* (2017), https://www.nclc.org/images/pdf/car_sales/report-auto-add-on.pdf; CONSUMER FEDERATION OF AM., *THE HIDDEN MARKUP OF AUTO LOANS: CONSUMER COSTS OF DEALER KICKBACKS AND INFLATED FINANCE CHARGES* (2004), <https://consumerfed.org/wp-content/uploads/2010/08/Hidden%20Mark%20Up%20of%20Auto%20Loans%200104.pdf> (hereinafter *THE HIDDEN MARKUP OF AUTO LOANS*); MARK A. COHEN, *REPORT ON THE RACIAL IMPACT OF AHFC’S FINANCE CHARGE MARKUP POLICY* (June 30, 2004), https://consumerfed.org/wp-content/uploads/2004/07/7-30-04-Racial-Impact-Finance-Charge-Markup_Report.pdf.

advantage of minority borrowers.⁴ S. J. Resolution 57, sponsored by Senator Jerry Moran of Kansas, and H. J. Res. 132, introduced by Representative Lee Zeldin of New York, would use a procedure under the Congressional Review Act to invalidate the CFPB's guidance with a simple majority vote in both houses of Congress.⁵

Using the Congressional Review Act to overturn this protection against discriminatory auto lending is a problem for two reasons. First, dealer markups are an opaque, anti-competitive practice that inflate the price of car loans for everyone and are especially harmful for vulnerable minority borrowers. Second, S. J. Resolution 57 and H. R. 132 represent a dangerous expansion of the Congressional Review Act that could lead to further policy gridlock in Washington and uncertainty in different markets across the economy.

Jim Crow Finance: How Auto-Dealer Markups Lead to Overpriced and Discriminatory Lending

When a car dealership sells a car and provides the financing, some dealers take a “dealer markup” by persuading the borrower to agree to a more expensive interest rate or payment terms than the borrower qualifies for.⁶ Auto lenders provide rate sheets to dealerships to give dealers a sense of what interest rates borrowers qualify for based on loan amount and credit history. The lender then compensates the dealer in exchange for persuading the borrower to agree to a higher interest rate. Auto dealers sometimes prefer to call these markups a “dealer discount.” But, put more simply, dealer markups are kickbacks to the dealership for convincing its customers to pay more interest over the life of their auto loans.

Dealer markups are bad for borrowers because borrowers are misled into paying hundreds or thousands of dollars more for their vehicles than they should have to pay based on their lender's own estimate of a fair, risk-based price for the financing. Dealers would prefer to keep this practice legal, however, because they make more money. Lenders, in turn, agree to pay these dangerous and anticompetitive kickbacks because they want to maintain market share by attracting dealers that want the flexibility to wring more compensation out of unsuspecting consumers.

⁴ Yuka Hayashi, *GOP Lawmakers Aim to Kill Auto-Lending Discrimination Rule Soon*, WALL ST. J. (Apr. 13, 2018, 4:35 PM), <https://www.wsj.com/articles/gop-lawmakers-aim-to-kill-auto-loan-discrimination-rule-soon-1523651735>.

⁵ S. J. Res. 57, 115th Cong. (2018), <https://www.congress.gov/bill/115th-congress/senate-joint-resolution/57/text>; H. J. Res. 132, 115th Cong. (2018), <https://www.congress.gov/bill/115th-congress/house-joint-resolution/132/text>.

⁶ *Fact Sheet*, *supra* note 2.

A parallel practice called “yield spread premiums” used to exist in the home mortgage lending market.⁷ Prior to the 2008 financial crisis, yield spread premiums were one of the most common and objectionable practices in subprime and exotic mortgage lending.⁸ In this context, mortgage brokers persuaded borrowers to take on more expensive, riskier loans with teaser interest rates and higher overall costs over the life of the loan. Lenders did this because, on paper, loans with yield spread premiums looked like they would produce more income for investors. So, when the lender or its assignee packaged the loan into residential mortgage backed securities issued on Wall Street the loan would fetch a higher price because it was expected to produce a higher yield over the life of the loan. Lenders shared this higher revenue with mortgage brokers by giving them larger commissions in exchange for steering customers into less favorable financing.⁹ After the crash, the Federal Reserve Board of Governors adopted a regulation prohibiting yield spread premium compensation.¹⁰ Congress then incorporated a similar rule in the Dodd-Frank Act, which was eventually codified into a regulation issued by the Consumer Financial Protection Bureau.¹¹

Thus, compensation structurally similar to auto dealer markups is currently altogether illegal in the mortgage lending industry, and for good reasons. Not only does this form of hidden price kickbacks lead to families paying higher interest rates than they qualify for, it can also have subtle, discriminatory effects. Just like the mortgage market before 2008, empirical evidence suggests that when car salespeople negotiate with minority borrowers, whether it happens intentionally or not, on average these borrowers end up with higher interest rates than similarly situated white borrowers.¹² While some white borrowers also pay more than they should, discriminatory dealer markups are particularly problematic for African American and Latino borrowers.¹³

Dealer markups reflect a sad legacy of “Jim Crow” financial practices with discriminatory effects on vulnerable minority borrowers. Despite their prevalence in the current marketplace, dealer markups are illegal under the Equal Credit Opportunity Act (ECOA) whenever they have the effect of imposing discriminatory pricing on a protected class of borrowers. Adopted in 1974, ECOA makes it unlawful for any creditor to discriminate against any loan applicant, with respect to any aspect of a credit transaction, on the basis of

⁷ Christopher L. Peterson, *Federalism and Predatory Lending: Unmasking the Deregulatory Agenda*, 78 TEMPLE L. REV. 1, 16–18 (2005).

⁸ *Id.*

⁹ Taiesha L. Cantwell, *Yield Spread Premiums: Who's Working for the Borrower? HUD's Erroneous Regulation and Its Bar on Plaintiffs*, 21 LAW & INEQ. 367, 372-75 (2003).

¹⁰ *Federal Reserve announces final rules to protect mortgage borrowers from unfair, abusive, or deceptive lending practices that can arise from loan originator compensation practices*, BD. OF GOV.'S OF THE FED. RES. SYS. (Aug. 16, 2010), <https://www.federalreserve.gov/newsevents/pressreleases/bcreg20100816d.htm>.

¹¹ 12 C.F.R. 1026 (2013).

¹² See NAT. FAIR HOUSING ALLIANCE, *supra* note 3.

¹³ *Fact Sheet*, *supra* note 2.

race, color, religion, national origin, sex, marital status, age, or the fact that all or part of the applicant's income derives from a public assistance program.¹⁴ Both before and after the CFPB's guidance, it was illegal for an auto finance company to have markup and compensation policies for auto dealerships that impose price disparities among equally qualified car buyers of different races. Any indirect auto lender with reasonable notice of a dealer's discriminatory conduct cannot legally facilitate that unlawful discrimination.

This discriminatory impact is why the CFPB issued guidance explaining that dealer markups were illegal when they have a discriminatory effect on borrowers. Dealers and lenders were on notice for years that their markup practices were legally on thin ice anytime consumers could introduce empirical evidence of discriminatory effects. Indeed, the Consumer Federation of America issued a report condemning the discriminatory effect of dealer markups as early as 2004.¹⁵ The Bureau's short, five-page bulletin simply put car dealerships and auto-finance companies on notice that the CFPB was paying attention. Rather than imposing any new rule on the industry, the guidance document merely encouraged auto lenders to engage in compliance management and auditing to ensure that their dealer markup and compensation policies were not imposing discriminatory prices on customers.¹⁶ Auto finance companies and car dealerships, however, do not want to end dealer markups because it is profitable for families to pay higher interest rates than they qualify for – why have the customer pay less when they could pay more?

Moreover, the market has not been able to correct for dealer markups or effectively force price competition because consumers themselves do not understand the interest rates for which they qualify.¹⁷ Current price disclosure laws, such as the Truth in Lending Act, do not explicitly require either the dealer or the auto finance company to inform the borrower that they are being assessed a subjective charge that is unrelated to their credit worthiness. Consumers are shown a price disclosure document, but they are not told that their rate was arbitrarily inflated by the dealer so that the dealer could receive a kickback from the finance company. When taking a dealer markup, the standard industry practice is to prepare the closing documents in a way that the customers are not alerted to the fact that they are negotiating with an individual that has the ability to determine the ultimate price of their loan.¹⁸ Indeed, many dealership finance managers present themselves as an ally of the customer facilitating the

¹⁴ 15 U.S.C. § 1961(a)

¹⁵ THE HIDDEN MARKUP OF AUTO LOANS, *supra* note 3.

¹⁶ Consumer Financial Protection Bureau, Indirect Auto Lending and Compliance with the Equal Credit Opportunity Act, CFPB Bulletin 2013-02 (March 21, 2013), at 4.

¹⁷ See Bd. of Gov.'s of the Fed. Res. Sys., Final Rule, Official Staff Commentary, Fed. Reg. Vol. 75, No. 185, 58509, 58515 (Fri. Sept. 24, 2010) (concluding “Because consumers generally do not understand the yield spread premium mechanism, they are unable to engage in effective negotiation. Instead they are more likely to rely on the loan originator’s advice, and, as a result, may receive a higher rate or other unfavorable terms solely because of the greater originator compensation.”).

¹⁸ THE HIDDEN MARKUP OF AUTO LOANS, *supra* note 3.

mistaken belief that it is the bank or finance company that unilaterally sets the borrower's interest rate.

Congressional Review Act Reversal of Agency Guidance: An Unprecedented Move

Under the Congressional Review Act of 1996 (CRA),¹⁹ Congress can invalidate regulations adopted by federal agencies with a simple majority vote in both houses.²⁰ The CRA provides that, before a new rule can take effect, the agency issuing the regulation must submit to Congress: a copy of the rule, a concise summary, and its proposed effective date. Once a rule is officially submitted to Congress, the rule is subject to repeal under expedited procedures for a period of 60 legislative days through a “resolution of disapproval.” If the President signs the resolution, the regulation is immediately invalidated, and the issuing agency is prohibited from promulgating a new rule that is “substantially the same” as the rescinded rule.²¹

While Congress has traditionally used this power infrequently, application of the Congressional Review Act has increased during the Trump administration.²² What Congress has never done before, however, is use the Congressional Review Act to invalidate an action taken by an administrative agency that the agency itself has not characterized as a rulemaking.

This is precisely what S. J. Resolution 57 and H. J. Res. 132 would do – invalidate the CFPB's 2013 auto lending guidance using the Congressional Review Act.²³ While the Congressional Review Act typically limits the amount of time Congress can invalidate a regulation after the administrative agency sends the regulation to Congress,²⁴ the CFPB never sent its auto-lending guidance to Congress because the CFPB did not view it as a regulation. The CFPB's original position was that discrimination in auto lending has been illegal ever since Congress itself prohibited racial discrimination in all forms of consumer credit through the Equal Credit Opportunity Act. The CFPB's bulletin document simply reflects existing caselaw interpreting the application of the Equal Credit Opportunity Act in both the auto finance market as well as home mortgage lending market. Rather than issuing a

¹⁹ 5 U.S.C. §§ 801–808.

²⁰ 5 U.S.C. § 802.

²¹ 5 U.S.C. § 801(b)(2).

²² Stephen Dinan, *GOP rolled back 14 of 15 Obama rules using Congressional Review Act* (May 15, 2017), <https://www.washingtontimes.com/news/2017/may/15/gop-rolled-back-14-of-15-obama-rules-using-congress/>.

²³ S. J. Res. 57, 115th Cong. (2018), <https://www.congress.gov/bill/115th-congress/senate-joint-resolution/57/text>.

²⁴ 5 U.S.C. § 802 (giving Congress “60 session days” to invalidate a regulation).

new regulation, the Bureau’s guidance provided notice to auto dealers and financial institutions that enforcing longstanding law would be a priority and reminding indirect auto lenders to consider whether their practices allow discretionary pricing that can lead to illegal discrimination. The CFPB provided the guidance to assist financial companies on how to comply with existing law, not to create new requirements.

In recent months, however, the Government Accountability Office took the position that the CFPB’s auto lending guidance was sufficiently detailed enough to constitute a regulation under the Congressional Review Act.²⁵ Because the CFPB never started the clock on the Congressional Review Act by sending the guidance to Congress, some Congressional leaders now believe it is not too late for a Congressional Review Act resolution invalidating this auto finance guidance that was really not a regulation, even though it has been nearly half a decade since the Bureau issued the guidance.²⁶

This use of the Congressional Review act is extreme and unprecedented. Not only do S. J. Resolution 57 and H. J. Res. 132 embrace an anticompetitive, discriminatory car dealer’s trick, they threaten to cast a shadow across the ordinary and normal operation of government. All of the federal banking regulatory agencies have at times promulgated various guidelines, bulletins, and guidance letters—all of which could now be susceptible to challenge with a CRA resolution under the analysis in the GAO determination. This dangerous precedent will mean that in the future, businesses will face uncertainty over whether agency interpretations of the law may be attacked and invalidated by Congressional Review Act resolutions years after the fact. The GAO determination in combination with Congressional action will discourage helpful and efficient communication by the CFPB and other regulators. In seeking a short-term policy goal for auto dealers and indirect auto finance businesses, Congress risks increasing confusion and miscommunication between the government and businesses in every sector of the economy. The appropriate method for Congress to address this type of policy concern is through the normal legislative process.

Conclusion: Short and Long Term Problems with Congressional Review Act Invalidation of CFPB Guidance

²⁵ U.S. GOV’T ACCOUNTABILITY OFFICE, B-329129, Letter on Bureau of Consumer Financial Protection: Applicability of the Congressional Review Act to Bulletin on Indirect Auto Lending and Compliance with the Equal Credit Opportunity Act (Dec. 5, 2017).

²⁶ Katanga Johnson, *U.S. senate panel plans to repeal auto lending rules: Toomey*, REUTERS (Apr. 10, 2018, 10:55 AM), <https://www.reuters.com/article/us-usa-senate-toomey/u-s-senate-panel-plans-to-repeal-auto-lending-rules-toomey-idUSKBN1HH2RZ>.

Using the Congressional Review Act to invalidate the CFPB's auto lending guidance is problematic for two reasons. First, in the short term, dealer markups are a harmful and potentially racist lending practice. They are anticompetitive, opaque, and create inflated costs in the market, especially for vulnerable borrowers and minority populations. As a matter of policy, the CFPB's auto lending guidance is a modest and reasonable interpretation of existing law. A better long-term policy would be to adopt legislation or regulations that would require the auto finance market to follow the prohibition of yield spread premium compensation in the mortgage market by eliminating dealer markups altogether. Although the mortgage market had some growing pains, it adjusted and is doing just fine without these shadowy, anti-competitive, and discriminatory pricing mechanisms. But, at a minimum, if auto-dealers and lenders insist on continuing to use dealer markups, the Equal Credit Opportunity Act forbids doing so in a way that has a discriminatory effect on protected classes of borrowers.

Second, over the long term, using the Congressional Review Act to invalidate the CFPB's auto lending guidance is a dangerous expansion of the Act that could exacerbate partisanship and gridlock in Washington. Businesses, consumers, and the public at large need administrative agencies to provide effective non-binding communication and guidance to the markets of agencies' views. If Congress can look back nearly half a decade into the past and invalidate guidance that merely explains existing regulations and longstanding precedent, it will cast a cloud of uncertainty over how government works and make it harder to do business in America over time. Financial institutions, as well as ordinary Americans, should not consent to Congress enfeebling ordinary administrative communication for the sake of one short term policy goal.

Congress should not bend procedural rules and governance norms to facilitate the financial tricks and traps of car dealerships. Dealers and auto lenders deserve to receive fair compensation for their work. But in order for markets to be effective, consumers must be able to effectively compare prices and should not be subject to hidden kickbacks that inflate their interest rates beyond a risk-adjusted price. Instead of voting to facilitate dealer markups, Congress should adopt legislation banning dealer markups altogether. Indeed, Congress already took this approach in the home mortgage market when it prohibited yield spread premium compensation to mortgage brokers and similar forms of commissions to in-house loan officers. Specifically, following current home mortgage lending law, Congress should prohibit lenders from paying dealer compensation that varies based on loan terms other than the amount financed. Or, in the alternative, Congress should hold hearings to explore whether the Federal Trade Commission or the Consumer Financial Protection Bureau should begin a notice and comment rulemaking to eliminate dealer markups altogether under their existing authority to prohibit unfair, deceptive, or abusive practices.

Advice for Consumers

Consumers should take reasonable steps to avoid paying inflated finance charges associated with dealer markups. This includes shopping for the right auto loan with the lowest interest rate before they approach a dealership. Arranging finance in advance through a reputable credit union or bank puts consumers in a stronger position when negotiating over the price of the vehicle.

Consumers will generally find the best interest rate by comparing offers from multiple lenders. While it can take some time to shop for the right loan, arranging financing in advance can save thousands of dollars over the life of the loan. For many consumers, shopping for the right loan may be more important than shopping for the car or truck itself.

Consumers should also approach special credit offers from dealerships with caution. For example, some dealerships may offer “zero percent” financing, but refuse to offer a rebate on the sale price of the vehicle. For some customers, forgoing the rebate may be more expensive than taking advantage of the zero percent financing. Car buyers should consider asking their bank or credit union whether it makes sense to take a dealer rebate and finance the car with the credit union or bank. Then, consumers should compare the calculations of the credit union or bank with those of the dealership and select the lowest price overall.
