

Review of the Larger Participant Rule for Non- Banks in the Automobile Financing Market and the CFPB's Examination Procedures

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The Larger Participant Rule – Who does it Affect

- The CFPB recently issued its final rule allowing it to supervise nonbank companies that qualify as “larger participants” of the market for automobile financing
- This rule is effective sixty (60) days after publication in the Federal Register
- The rule applies to all service providers of “larger participants”, including repossession companies and forwarders

The Larger Participant Rule - Background and History

First quarter of 2014:

- 87.4 million outstanding auto loans valued at nearly 900 billion dollars
- Leases comprise 30% of new vehicle automotive financing transactions (up 20% from 5 years ago)

Market includes over 500 nonbank auto lenders

The new rule is the fifth CFPB rule or proposed rule defining larger market participant: consumer reporting, consumer debt collection, student loan servicing, and international money transfers

The Larger Participant Rule

The Larger Participant Rule defines:

1. certain nonbank covered persons as larger participants of a market for automobile financing that includes grants of credit for the purchase of an automobile, refinancing of such credit obligations and any subsequent refinancing thereof, purchases or acquisitions of such credit obligations (including refinancing), automobile leases, and purchases or acquisitions of automobile lease agreements.

The Larger Participant Rule (cont.)

The Larger Participant Rule:

2. defines the term “financial product or service” to include certain types of automobile leases that non-banks are authorized to offer and the CFPB finds have or likely will have a material impact on consumers

3. makes technical corrections to clarify the affiliate aggregation requirements set forth in two earlier larger participant rules.

Who is a nonbank under the Rule?

Nonbank participants under the rule include:

1. Specialty finance companies
2. “captive” non banks
3. Buy Here Pay Here finance companies

In addition, CFPB can supervise any nonbank auto finance company – regardless of size – that is engaging or has engaged in conduct that poses risks to consumers with regard to the offering or provision of consumer financial products or services.

Who is a nonbank under the Rule? (cont.)

The following are excluded under the rule:

1. automobile title lending – expected to be subject to another larger participant rule
2. securitizations of auto loans and leases

Definitions

Automobile – any self-propelled vehicle primarily used for personal, family or household purposes for on-road transportation. Applies to both new and used vehicles. The definition excludes motor homes, recreational vehicles (RVs), golf carts and motor scooters.

Aggregate annual originations – the sum of the number of annual originations of a nonbank covered person and the number of annual originations of each nonbank covered person's affiliated companies.

Definitions (cont.)

Annual originations - the sum of the following transactions for the preceding calendar year: grants of credit for the purchase of an automobile, refinancing of such credit obligations and any subsequent refinancing thereof, and purchases or acquisitions of such credit obligations. Excludes annual originations from any investments in asset-backed securities.

Aggregating the annual originations of affiliated companies – the annual originations of a nonbank covered person and its affiliated companies would be aggregated for the entire preceding calendar year even if the affiliation did not exist for the entire preceding year.

Definitions (cont.)

Automobile financing – the granting of credit for the purpose of purchasing an automobile; refinancing existing credit obligations or previously refinanced credit obligations that had been made for the purchase of an automobile; purchasing or acquiring such credit obligations (including refinancing); providing automobile leases; and purchasing or acquiring automobile lease agreements.

Test to Define Larger Participants

Under the rule, a nonbank covered person is a larger participant of the automobile financing market if it has at least 10,000 aggregate annual originations.

CFPB estimates that approximately 38 entities fall within the supervisory authority.

These 38 entities are responsible for approximately 91% of the activity in the nonbank automobile financing market

CFPB Examination Procedures under the New Rule

Module 1- Company Business Model

Module 2 – Compliance Management System

Module 3- Advertising and Marketing

Module 4 – Application and Origination

Module 5 – Payment Processing, Account Maintenance and Optional Products

CFPB Examination Procedures under the New Rule (cont.)

Module 6- Collections, Debt Restructuring, Repossessions and Accounts in Bankruptcy

Module 7 – Customer Complaints and Inquiries

Module 8 – Credit Reporting, Information Sharing and Privacy

Module 9 – Examiner Conclusions and Wrap-up

Applicable Laws

- Truth in Lending Act (TILA)
- Electronic Fund Transfer Act (EFTA)
- Fair Debt Collections Practices Act (FDCPA)
- Fair Credit Reporting Act (FCRA)
- Gramm-Leach-Bliley Act (GLBA)
- Equal Credit Opportunity Act (ECOA)
- Consumer Credit Protection Act (CCPA)
- Consumer Leasing Act (CLA)
- Unfair, Deceptive Acts and Practices (UDAAP)

Module 1 – Company Business Model

- Identify the business model of the regulated entity:
 - Product type
 - Services offered
 - Organizational chart
 - Responsibilities of top managers and key personnel
 - Review audit procedures
 - Confirm audit is independent of business functions
 - Understand branch structure

Module 2- Compliance Management System

“Entities may be responsible for the activities of service providers. Examiners should ensure that such entities appropriately manage their relationships with service providers.”

Specifically, examiners should investigate the following:

1. Confirm written agreements with service providers;
2. Evaluate compliance management controls for selecting service providers;
3. Ensure steps are taken to ensure proper licensing of service providers;

Module 2- Compliance Management System (cont.)

4. Evaluate whether the lender monitors the screening, hiring and training practices of service providers' employees who perform services for the lender;
5. Evaluate lender's due diligence in engaging service providers;
6. Evaluate whether the lender takes the necessary steps to ensure the service provider's compliance with the lender's privacy policies with respect to consumer data; and,
7. Evaluate whether the lender conducts internal or external audits of the service provider's activities

Module 3 – Advertising and Marketing

- Examiners will ensure lender’s advertisements and promotional material comply with federal law
- Clear and conspicuous identification of material terms of lending agreement: APR, terms, down payments, add-ons
- Specific emphasis on use of terms “rewards”, “discounts” and “free” in marketing and advertising

Module 4 – Application and Origination

As it relates to ECOA, CFPB's supervisory guidance indicates that entity should consider limits on discretionary markups and engage in self-monitoring which includes statistical analyses to identify disparities on a prohibited basis.

Such analysis should include use of regression models to test whether a specific policy results in unlawful differences based on race, national origin or other prohibited basis characteristics, e.g. Bayesian Improved Surname Geocoding

Module 4 – Application and Origination (cont.)

CFPB has identified the following elements in well-developed fair lending compliance systems:

- An up-to-date fair lending policy statement
- Regular fair lending training for all employees
- On going monitoring
- Regular assessment of the marketing of loan products
- Meaningful board involvement
- Review of fair lending policies for disparate impact
- Statistical analysis of loan data for disparities on a prohibited class basis in pricing, underwriting, or other aspect of the credit transaction.

Real Life Effects of Supervision - ECOA

Examination and enforcement teams of the CFPB have already reached resolutions with several supervised institutions that will collectively pay about \$136,000,000 to provide redress for up to 425,000 borrowers.

Most notably, one auto lender - \$80,000,000 for approximately 235,000 borrowers

ECOA reviews have targeted: credit approvals and denials, interest rates quoted by the lender to dealer (“buy rates”) and discretionary markup or adjustments to the buy rate.

Module 5 – Payment Processing, Account Maintenance and Optional Products

This is all about the handling and processing of the consumer's funds:

1. Timeliness of payment posting;
2. Consumer access to loan information;
3. Assessment of fees consistent with contract;
4. Order of payment application;
5. Handling partial payments; and,
6. Handling leases for service members

Module 6- Collections, Debt Restructuring, Repossessions and Accounts in Bankruptcy

This module ties into the Compliance Management System set forth in Module 2

Specifically as to repossessions the examiner shall:

“Assess the lender’s policies and procedures for repossessions including how the lender oversees and communicates with service providers performing repossession services.”

“Assess if complaint (oral and written) from consumers regarding service providers are resolved promptly.”

Module 6- Collections, Debt Restructuring, Repossessions and Accounts in Bankruptcy

Areas of specific concern:

1. Repossession of a vehicle owned by a consumer who is current;
2. Assess for systems to ensure compliance with Service Members Civil Relief Act (SCRA);
3. Ensure that accounts are properly flagged for bankruptcy;
4. Ensure Starter Interrupter Devices (SID) are utilized properly; and,
5. Ensure UDAAP compliance - query: contingent recovery

Module 7 – Customer Complaint and Inquiries

Remember handling of consumer complaints applies equally to lender and service provider

Consumer complaint policy:

- Policy is documented
- Policy is available to staff and consumers
- Policy is reviewed annually
- Policy is written in plain, understandable English or any other geographically appropriate language
- Effective complaint handling is supported by the board of directors or ownership
- Board or directors or ownership are responsible for effective operation of the complaint system
- Policy and procedures associated with the complaint system are communicated to all employees
- Appropriate resources are allocated to enable the complaint system to function
- Complaint handling responsibilities are incorporated into staff position descriptions
- Employees have specific instructions on how to handle complaints
- Employees are given written instructions on complaint procedures
- There is a comprehensive complaint handling instruction manual for employees
- The complaint manual is regularly reviewed and updated
- The complaint procedures manual is easily accessible to any employee
- The procedures or complaint manual provides guidance on what remedies can or should be used to resolve complaints

Module 7 – Customer Complaint and Inquiries (cont.)

Customers are told how to make a complaint:

- Complaint forms are readily available to consumers
- Complaint forms or signs are displayed prominently in public areas and are readily accessible
- Complaint information is included on company's web page
- Consumers can make complaints in numerous formats, i.e. in person, mail, e-mail etc.

Consumers are provided assistance to make complaints where needed

Complaint system is free of charge

Complaints are recorded in a complaint database

Outcomes of complaints are recorded

Module 8- Credit Reporting, Information Sharing and Privacy

- Focus is upon GLBA and FCRA
- Specifically, accuracy of reported information, policies and procedures surrounding data accuracy, timely reporting

Module 9- Examiner Conclusion and Wrap-up

- Root cause analysis
- Training issues
- Deficient policies and procedures
- Failure of service provider oversight
- Compliance management weaknesses

Violations can lead to enforcement action

We Appreciate Your Time

Questions?



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