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# Topics in F&I compliance

## Tips to help prevent charges of discriminatory and unfair practices

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> "Regulators, in general, are suspicious of discretionary pricing decisions that appear subjective and unrelated to creditworthiness factors."

### What are the steps to take now?

Dealers can mitigate the risk of being challenged, and if challenged, surviving the challenge, of discriminatory and unfair practices by implementing several practices, as follows:

- Using a credit score-driven rate matrix
- Standardizing dealer participation
- Always quoting a vehicle-only base payment
- Standardizing product gross margin and locking down the menu to avoid unauthorized alterations
- Using a menu selling solution that clearly shows all prices, payments amounts and other relevant terms

### Why?

- Many regulators and plaintiffs' attorneys believe that unlawful discrimination in violation of the Equal Credit Opportunity Act (ECOA) occurs in connection with the financing of vehicle purchases. This unlawful discrimination may be unintentional or intentional. Both are unlawful.
- The finance sources to whom you assign your retail installment contracts are being accused of unlawful discrimination, and are being examined for this practice. Because of this, they are scrutinizing for unlawful discrimination in the contracts they buy from dealers.

### What is unlawful discrimination?

- ECOA and Reg. B prohibit a creditor, in any aspect of a credit transaction, from treating one person less favorably than another similarly situated person on a "prohibited basis." The prohibited bases are color, religion, national origin, sex, marital status, age (provided the person has the capacity to enter into a contract), because the person receives some type of public assistance, or because a person has asserted rights under a consumer credit protection statute. Persons who are the subject of these prohibited bases are referred to as "protected classes." Be aware that many states have anti-discrimination statutes, and have expanded the classes of prohibited basis. A few examples of additional prohibited basis in certain states are disability, military status, sexual orientation and gender identity.

### So, what is the crux of unlawful discrimination?

- Many regulators believe that certain protected classes are charged higher APRs, many times due to higher dealer participation. The regulators assume that it's due to unlawful discrimination and not legitimate factors that are unrelated to the prohibited bases. The assumption is that the larger the differences between the APRs charged to members of the protected classes, as compared to APRs charged to non-protected class members, the more likely the differences are due to unlawful discrimination.
- Regulators see dealer participation* as a completely subjective element in the ultimate price paid for credit and question the legitimacy of it being related to a valid factor in the transaction.

- Regulators, in general, are suspicious of discretionary pricing decisions that appear subjective and unrelated to creditworthiness factors.

## Really, you say. What's an example of this actually happening?

- Well, the United States Department of Justice (DOJ) sued Union Auto Sales (along with its finance source Nara Bank) alleging that Union Auto and Nara Bank violated the ECOA by having a policy that allowed employees to add discretionary dealer participation to installment contracts. And that this policy, they alleged, resulted in a pattern of discrimination against non-Asian applicants, Hispanics in particular.
  - The DOJ alleged that non-Asians were being charged dealer participation with more frequency and in greater amounts than Asians.
  - The statistical analysis allegedly showed that non-Asians were charged a higher dealer participation as compared to Asians.
- The crux of the lawsuit was that the dealer participation was subjective and unrelated to any creditworthiness standards. And because these differences could not be explained fully by factors unrelated to race or national origin such as the customers' creditworthiness, the court accepted the argument that they could be due to a prohibited bases.
- The challenged policy, which allegedly resulted in unlawful discrimination, gave subjective decision-making authority to employees in the setting of the dealer participation.
- United Auto Sales did not use formal, written, or uniform guidelines and procedures to set dealer participation. Employees were given the discretion to set dealer participation within broad parameters.

## Yikes, you say! What happened?

- Union Auto Sales settled with the DOJ, and agreed to pay $125,000 to non-Asian customers who were charged higher dealer interest rate markups. At the time of the settlement, Union Auto Sales was no longer in business and had no plans to re-enter the business. Union Auto agreed that if within two years of the consent decree, it or its principal shareholder re-entered the dealership business, it is required to implement clear guidelines for setting dealer participation and pricing, in compliance with ECOA, and establish appropriate fair lending training for its employees and officers.

  There are two other DOJ enforcement actions against dealerships worth noting. In 2007 the DOJ entered into settlement agreements with two Pennsylvania dealerships – Springfield Ford, Inc. and Pacifico Ford Inc. The DOJ charged the dealers with discriminating against African-American customers based on their dealer participation practices. Both dealerships settled. Springfield Ford agreed to pay $363,166 to African-American consumers who were charged higher interest rates, and Pacifico Ford similarly agreed to pay $94,565. The dealerships also agreed to change the way they set dealer participation to prevent discrimination, as follows:
  - Instituting formal, written guidelines for setting dealer participation using the following procedures:
    - Each transaction starting with the same, pre-determined dealer participation level (e.g., for every transaction the APR can only be marked up by 1.5%).
    - The dealer participation only being reduced for good faith competitive reasons.
    - Documenting the reason(s) in an established questionnaire for any deviations from the pre-determined dealer participation level.
    - Management reviewing all deviations from the pre-determined dealer participation level, along with all transaction and related documentation.

Patty Covington is a partner in the Virginia office of Hudson Cook, LLP. Patty has significant experience in the areas of dealer, credit, and privacy law.

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Hudson Cook, LLP practices in the area of consumer financial services and privacy law. The firm, founded in 1997, offers a full range of legal regulatory and compliance services in all areas and aspects of extending credit to consumers at the federal level, all 50 states and the District of Columbia, including auto sales, finance and leasing, mortgage financing and home equity programs, credit cards, boat financing, e-commerce, and other consumer credit services. In addition, the firm maintains a robust practice in the areas of privacy, data security, and marketing compliance.

## Okay, you have my attention, you say. What can I do to protect my dealership if I am ever challenged by the DOJ, another regulator or even a plaintiff?

- That's where the Rate Sheet and Instructions for Using the Rate Sheet can help. Zurich recommends that dealers use these tools to mitigate the risk and harm of a fair lending challenge.
- The risk of applying the dealer participation in a discriminatory manner, whether intentional or not, is reduced when the same policy and procedure for setting the dealer participation is applied consistently to all customers.
- Use of the Rate Sheet takes the subjectivity and employee discretion out of setting APRs.
- Use of the Rate Sheet results in a more uniform setting of APRs. The same APR will be set for all customers with the same credit profile.

## Is there anything else I should be concerned about?

- We're glad you asked! There is. It relates to add-on and ancillary products that you finance as part of a retail installment sales contract – how you sell the products you finance and how they are priced.

## How is the way I sell the add-on or ancillary product relevant?

- Well, just like the APR, the financing of add-on or ancillary products can be done in a way that might discriminate in an unlawful manner. Dealers must also remember that any practice of including add-on or ancillary products without the consumer's consent (i.e., payment packing), and similar conduct, is unlawful – no matter who the customer is.
- If the add-on or ancillary products you finance are sold is greater proportion to protected classes when compared to non-protected classes, regulators and plaintiffs' attorneys are likely to get suspicious. They will assume that it is due to unlawful discrimination and not to other legitimate factors unrelated to the prohibited bases.
- Like dealer participation, regulators see add-on and ancillary products as subject to unlawful discrimination when financed.

## What else should I be worried about with respect to add-on and ancillary products?

- In addition to differences in how these products are sold and what products are ultimately purchased by protected versus non-protected classes, you should also be mindful of the difference in prices paid by these groups for the same products. If protected classes pay more for the same products they finance when compared to non-protected classes, a regulator or plaintiff's attorney may assume it is due to unlawful discrimination. Further, if the dealer makes more profit on products financed for protected classes versus non-protected classes, again, the regulator may assume unlawful discrimination.

## What can I do to protect my dealership?

- Dealers should charge the same price for each add-on and ancillary product they sell of like terms and coverages. This practice should mitigate the risk and harm of a fair lending challenge.
- The risk of pricing the product in a discriminatory manner, whether intentional or not, is reduced when the same price is charged to all customers with respect to similar product of like terms and coverage.
- Additionally, this results in the same dealer profit; again mitigating the risk and harm of fair lending challenge.

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* Dealer participation is the amount of finance charge income you earn from originating retail installment sale contracts. It is the difference between the contract APR and the buy rate quoted to you by the finance source buying the contract.



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