

CFPB Drives Into Nonbank Auto Finance Regulation

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On June 10, 2015, the Consumer Financial Protection Bureau (“CFPB”) published a [Final Rule \(PDF\)](#) expanding its jurisdiction over “larger participants” in the nonbank automobile finance market, vesting itself with supervisory authority over covered companies that engage in at least 10,000 aggregate originations per year. This threshold brings approximately 34 nonbank companies and their affiliates that engage in auto financing under the supervisory jurisdiction of the CFPB. These combined entities are responsible for 91% of the activity in the nonbank auto finance market. Although this Rule imposes no new substantive compliance requirements on the covered auto finance companies, it marks the first time the CFPB will conduct regular, in-depth supervisory examinations into this segment of the industry. Concurrent with this Final Rule, the CFPB also released an [Automobile Finance Examination Procedures Manual \(PDF\)](#) that its examiners will use to monitor compliance.

Background of Larger Participant Rules

Currently, the CFPB only has supervisory jurisdiction as it relates to the auto finance industry over banks and credit unions with \$10 billion or more in assets. Under the Dodd-Frank Act, the CFPB has the power to regulate certain nonbank “larger participants” in markets for other consumer financial products or services. The CFPB has exercised this power to expand its supervisory role over various financial services industries a number of times in the past. In September 2014, the CFPB published a [Proposed Rule \(PDF\)](#), indicating its intention to supervise the nonbank auto finance industry. The Proposed Rule was made final last week with minimal changes and will become effective 60 days after it is published in the Federal Register, which will likely occur in the next several weeks.

Who is Covered and How Do We Count to 10,000?

Under the Final Rule, the CFPB will have supervisory authority over any nonbank covered entity engaged in automobile finance that, along with its affiliated companies, has at least 10,000 “aggregate annual originations” in the preceding year. Any service providers to the new “larger participants” that provide consumer financial products or services, regardless of size, will also fall under the CFPB’s new supervisory authority. As a result, the universe of nonbank larger participants can include not only traditional auto finance companies and manufacturer “captive” finance companies, but also “Buy Here Pay Here” finance companies.

The Final Rule does not institute a dollar amount threshold for nonbank covered entities, but simply focuses on the 10,000 “aggregate annual originations” threshold. The term “aggregate annual originations” is defined as the “sum of the number of annual originations of a nonbank covered person and the number of annual originations of each of the nonbank covered person’s affiliated companies.” To calculate the number of annual

originations, the CFPB will add the amount of the following automobile transactions in the preceding calendar year:

- Originations of retail installment contracts and direct purchase-money loans;
- Originations of a lease that qualifies as a full-payout lease and a net lease;
- Refinancings (and any subsequent refinancings) of these transactions that are secured by an automobile, regardless of whether the nonbank covered person was the original creditor, or the holder or servicer of the original obligation; and
- Purchases or acquisitions of the above transactions by the entity and its affiliates.

The inclusion of leases in the aggregate annual originations calculation under Proposed Rule generated the most comments and, accordingly, the most discussion by the CFPB in the Final Rule. Most in the industry argued that leases should not be included in the definition of an “annual origination”; however, the CFPB maintained that most automobile leases are the functional equivalent of purchase finance arrangements and drafted its Final Rule to include almost all leases in the threshold calculation. Although the CFPB limits the leases that qualify as a “financial product or service” to those that meet the technical definitions of full-payout leases and net leases, the practical effect is to cover almost every consumer motor vehicle lease.

The definition of an automobile includes cars, sport utility vehicles, light duty trucks, and motorcycles, but excludes motor homes, recreational vehicles (RVs), golf carts, and motor scooters.

Along with the exclusions from the definition of an automobile, the Final Rule also exempts certain other transactions. First, investments in asset-backed securities and those loan securitization purchases and related transactions that facilitate asset-backed securities will not count toward the 10,000 aggregate originations threshold. However, the CFPB chose not to define the terms “securitization” and “asset-backed securities” in its Final Rule. Additionally, a refinancing will be considered an annual origination only if it is secured by an automobile. Furthermore, certain dealers that extend retail credit or retail leases directly to consumers without routinely assigning them to unaffiliated third-party financing or leasing sources are excluded from the larger participant Final Rule. Specifically, such dealers do not qualify if they are predominantly engaged in the sale and servicing of motor vehicles, the leasing and servicing of motor vehicles, or both.

Finally, the Final Rule excludes auto title lending. However, the CFPB noted that title loans will likely be addressed in a future larger participant rulemaking because they are substantially different from the auto finance activities in this Rule. In fact, the CFPB’s [Spring 2015 Rulemaking Agenda](#) indicated that the supervision of larger participants in vehicle title loan markets is in a “Prerule Stage.”

Key Takeaways

The CFPB now has the authority to oversee any covered nonbank auto finance company, which means that these companies must review their policies and procedures in preparation for their upcoming CFPB examination. The CFPB has not yet indicated when the examinations will begin; however, initial reactions to the Final Rule by industry trade groups have noted that examinations may begin in late 2015. Interestingly, the Final Rule indicates that the CFPB will prioritize their examination schedule based on certain factors such as the size of each entity, the volume of its transactions, and the amount of complaints that the CFPB has received on the

entity. The CFPB will first notify the company before it takes any supervisory action, providing the company with the ability to dispute whether it qualifies as a larger participant.

These examinations are certain to be much more in-depth than a typical state regulator's examination and will function more along the lines of a bank examination. In fact, the Auto Finance Exam Manual will be used to examine both banks and nonbanks. Note that the CFPB still possesses the enforcement authority to issue a Civil Investigative Demand to covered persons, which may now come in addition to the new examinations. A wide divergence exists between the CFPB and industry trade groups regarding the cost of a compliance examination. While the CFPB estimates that the labor costs of an examination would total approximately \$28,000, industry trade groups place that estimate in the range of \$750,000 to \$1 million.

The Auto Finance Exam Manual (Exam Manual), which is new material created in addition to the Final Rule, is a valuable resource for supervised companies to use to begin the preparation for their upcoming examinations. This Exam Manual is modeled after the general [CFPB Supervision and Examination Manual \(PDF\)](#), but specifically tailored to the new auto finance Final Rule. The Exam Manual provides guidance as to how the CFPB will monitor the covered entities and how the examiners will conduct the exams. At its most basic level, the supervisory examination will monitor compliance with federal consumer financial laws. In both its [press release](#) and in the Exam Manual, the CFPB identified several federal laws and regulations for which it will conduct these exams:

- The CFPB's authority over Unfair, Deceptive, and Abusive Acts or Practices (UDAAPs);
- Truth-in-Lending Act (TILA) and Regulation Z;
- Fair Credit Reporting Act (FCRA) and Regulation V;
- Equal Credit Opportunity Act (ECOA) and Regulation B;
- Fair Debt Collection Practices Act (FDCPA);
- Consumer Leasing Act (CLA) and Regulation M;
- Electronic Funds Transfer Act (EFTA) and Regulation E; and
- Gramm-Leach-Bliley Act (GLBA) and Regulation P.

Of these federal laws, the CFPB has indicated that certain areas will likely garner more attention than others during the examinations of larger participant auto finance companies:

- **UDAAP violations in advertising.** Companies may not use misleading or deceptive tactics while marketing their products to consumers. The CFPB will review the auto finance terms, including the required TILA disclosure forms, to ensure they are properly disclosed and that consumers are not being misled about the benefits of financial products. Companies should review the [CFPB's June 2013 Consent Order against a national bank and one of its nonbank partner companies](#) that highlighted illegal disclosures and representations about products and services. While examining for UDAAP violations, the Exam Manual instructs the examiners to pay close attention to ancillary/add-on products such as GAP insurance and extended service contracts.
- **FCRA violations regarding inaccurate information to credit reporting agencies.** In its press release, the CFPB specifically mentioned its [August 2014 enforcement action against a Texas-based auto finance company](#), in which it fined the company \$2.75 million for failing to correct computing errors that provided

inaccurate information such as the consumers' payment history and delinquency status to credit bureaus. Companies should review this in conjunction with the Exam Manual to understand how the CFPB views fair credit reporting issues.

- **ECOA violations resulting from unfair lending.** The CFPB is continuing to closely monitor whether companies fairly offer financing to consumers under the Equal Credit Opportunity Act. This follows numerous CFPB enforcement actions, along with its [March 2013 Bulletin \(PDF\)](#) providing guidance to indirect auto lenders regarding discriminatory dealer markups.
- **FDCPA violations/vendor management and due diligence.** Once a consumer defaults on his account, he receives the benefit of strict rules governing the practices of both auto finance companies and their vendors. The CFPB will focus on servicers' debt collection tactics and the third-party service providers' repossession processes. The Exam Manual details how covered entities must have vendor management policies in place and actively perform due diligence to ensure that their third parties comply with federal laws.
- **CLA compliance.** Leasing is heavily discussed in the Final Rule, as the CFPB published a separate rule defining certain automobile leasing as a financial product or service in order to include it under the scope of certain consumer protections of the Dodd-Frank Act. In conjunction with this new authority, the CFPB will closely monitor the advertising and disclosure of lease terms for compliance under the CLA.

In light of the CFPB's continued focus on these areas, we recommend that all newly covered entities review their policies, procedures, and practices occurring within their business. If you have further questions on the CFPB's Larger Participant Final Rule, please contact one of the authors of this alert.

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