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CFPB to Supervise Non-Bank Auto Financing Companies

New Rule Also Broadens the Definition of a Consumer Financial Product or Service to Include Auto Leases

SUMMARY

On June 10, 2015, the Consumer Financial Protection Bureau (the “CFPB”) announced a final rule that extends the Bureau’s supervisory authority to dozens of large non-bank automobile financing companies and their affiliates, including specialty finance companies, manufacturer “captive” finance companies and “Buy Here Pay Here” finance companies. Although non-bank auto financing companies, both large and small, have been subject to CFPB rulemaking and enforcement jurisdiction since the Bureau’s establishment in July 2011, the final rule makes these large non-bank auto financing companies, which originate approximately 90 percent of non-bank auto loans and leases,¹ subject to CFPB supervision, including regular CFPB examinations. The final rule also extends the definition of a consumer “financial product or service” subject to CFPB jurisdiction to include certain auto leases that may not meet the existing definition. Simultaneous with the final rule’s announcement, the CFPB announced updates to its Supervision and Enforcement Manual (the “Manual”) to provide guidance on how the CFPB will monitor bank and non-bank auto finance companies for potential risks to consumers and compliance with federal consumer financial law.

The rule and updates to the Manual are the latest in the CFPB’s ongoing efforts to regulate activity in the \$900 billion direct and indirect automobile lending market. The rule will increase compliance costs for the non-bank auto finance companies facing CFPB examinations for the first time, but level the playing field with their bank-affiliated competitors who are already subject to CFPB or banking agency supervision.

BACKGROUND

The Consumer Financial Protection Act of 2010 (the “Act”), Title X of the Dodd-Frank Act, grants the CFPB authority to supervise large banks with assets of more than \$10 billion, and certain non-bank companies defined through CFPB rulemaking, for compliance with federal consumer financial protection laws, including (among others) the Act’s prohibition against “unfair, deceptive, or abusive acts or practices,” as well as the Equal Credit Opportunity Act (the “ECOA”), the Truth in Lending Act and the Consumer Leasing Act, among others.²

With respect to large banks, CFPB examinations have for several years included reviews of direct and indirect auto lending practices. For example, the Manual includes procedures for reviewing auto lending practices of banks for compliance with fair lending laws, including discriminatory lending practices proscribed by the ECOA.³

In addition to large banks, the Act grants the CFPB authority to supervise any company, and its service providers, to the extent the company provides a “consumer financial product or service” and meets particular criteria, which for present purposes means the company qualifies as a “larger participant of a market for . . . consumer financial products or services.”⁴ The Act defines certain “financial products or services” and allows the CFPB rulemaking authority to expand that definition in certain circumstances.⁵

On September 17, 2014, the CFPB issued a proposed rule defining “larger participants” in the market for automobile financing.

After a comment period, on June 10, 2015 the CFPB issued its final rule, which largely adopted the September 2014 proposed rule. The final rule will become effective 60 days after its publication in the Federal Register.

NEWLY COVERED COMPANIES AND EXAMINATION PROCEDURES

Under the final rule, a company and its service providers are deemed to be “larger participants” in the “automobile financing” market, and thus subject to CFPB regulatory oversight, if the company and its affiliates engage in at least 10,000 aggregate annual “originations,” which include the following types of transactions:

- Credit for the purpose of an auto purchase;
- Refinancing of auto purchase loans;
- Auto leases; or
- Purchases or acquisitions of any of the foregoing obligations.⁶

The final rule is expected to cover “captive” financing companies of major automobile manufacturers, as well as specialty finance companies and so-called “Buy Here Pay Here” finance companies, among

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others. The Act expressly excludes most dealers from CFPB jurisdiction. However, in the final rule, the CFPB broadens the exclusion to cover certain dealerships (typically, “Buy Here Pay Here” dealerships) who might otherwise be included within the rule (and therefore subject to the CFPB’s supervision), although these dealerships are already subject to the CFPB’s enforcement and rulemaking jurisdiction.⁷ The final rule also excludes investments in asset-backed securities, including acquisitions by special purpose vehicles established to facilitate asset-backed securities transactions, from the definition of the auto financing market.⁸ Accordingly, asset-backed securities transactions will not count toward the 10,000 transaction threshold.

In addition, the final rule marks the first time that the CFPB has exercised rulemaking authority under the Act to expand the definition of a “financial product or service.” The CFPB has this authority if the product or service (a) is permissible for a bank or bank holding company and (b) has a material impact on consumers.⁹ In this case, the CFPB made these findings. The CFPB noted that to be covered under the existing statutory definition of leases that qualify as “financial products or services,” the leases must be “the functional equivalent of purchase finance arrangements,”¹⁰ in addition to meeting other requirements. The CFPB noted that there is some uncertainty about how that term should be interpreted. It could be read to exclude from the Act’s protections a significant number of consumer automobile leasing activities. The CFPB reasoned that the existing definition might cause confusion about which consumer automobile leases were covered by the Act and which were not. The CFPB determined that the purposes of the final rule and the CFPB’s “overall mission are best served” by covering automobile leasing more broadly.¹¹ Specifically, the final rule defines an automobile lease to include leases that national banks are authorized to make. Under federal law, national banks may engage in leasing activities without the leases being the functional equivalent of purchase finance arrangements.¹²

Finally, the CFPB published an update to its Manual, titled “Automotive Finance Examination Procedures,” which describes procedures that CFPB examiners will follow in evaluating the bank and non-bank auto financing companies the CFPB supervises.¹³ According to those procedures, examiners will look at compliance systems, advertising and marketing practices, loan and lease applications and originations, payment processing systems, account maintenance, as well as optional add-on products offered to consumers. Examinations will also evaluate debt collection, restructuring and repossession practices, customer service practices and credit reporting and consumer privacy issues.¹⁴ Specifically, the CFPB’s press release highlighted four areas that the Bureau’s examiners “will be evaluating” during examinations: (1) marketing practices and loan term disclosures “to ensure [companies] are not using deceptive tactics to market loans or leases”; (2) “whether information auto finance companies provide to credit bureaus is accurate”; (3) debt collection practices “to ensure that collectors are relying on accurate information and using legal processes when they collect on debts”; and (4) whether auto financing companies are “lending fairly” under the ECOA and CFPB rules.¹⁵ The CFPB estimates the average

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duration of on-site examinations will be about nine weeks, but has not provided an estimate of the anticipated frequency of examinations.¹⁶

IMPLICATIONS

The final rule will have an immediate impact on about three dozen non-bank auto financing companies and their affiliates not previously subject to direct CFPB supervision, although they have been subject to its rulemaking and enforcement authority from the CFPB's inception. Among other things, those companies will face increased compliance costs arising from periodic CFPB examinations and direct scrutiny of their compliance management systems by examiners. Those examinations may reveal past or present noncompliance with consumer financial laws, which the CFPB may "seek to correct through supervisory activity or, in some cases, enforcement actions," thus leading to additional compliance costs and increased litigation risks.¹⁷ Among other areas of recent CFPB focus are discretionary pricing policies and practices by indirect auto lenders that could result in a discriminatory impact on certain minority groups.¹⁸

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ENDNOTES

- 1 June 10, 2015 CFPB Press Release, *available at*
<http://www.consumerfinance.gov/newsroom/cfpb-to-oversee-nonbank-auto-finance-companies/>.
- 2 12 U.S.C. §§ 5515, 5531. The Act also provides authority over large credit unions, as well as
some supervisory authority over smaller banks and credit unions. 12 U.S.C. § 5516.
- 3 CFPB Supervision and Examination Manual at Procedures 4-5 (2012), *available at*
<http://www.consumerfinance.gov/guidance/supervision/manual/>.
- 4 12 U.S.C. §§ 5481(6), 5512(b), 5514(a)(1)(B), 5514(a)(2).
- 5 12 U.S.C. § 5481(15)(a)(xi).
- 6 Defining Larger Participants of the Automobile Financing Market and Defining Certain Automobile
Leasing Activity as a Financial Product or Service, Fed. Reg. Docket No. CFPB-2014-0024, at
114 (to be codified at 12 C.F.R. § 1090.108(a)), *available at*
http://files.consumerfinance.gov/f/201506_cfpb_defining-larger-participants-of-the-automobile-financing-market-and-defining-certain-automobile-leasing-activity-as-a-financial-product-or-service.pdf.
- 7 *Id.* at 74-75 (citing 12 U.S.C. § 5519).
- 8 *Id.* at 114 (to be codified at 12 C.F.R. § 1090.108(a)(i)(B)).
- 9 12 U.S.C. § 5481(15)(A)(xi)(II)
- 10 Fed. Reg. Docket No. CFPB-2014-0024 at 12-13.
- 11 *Id.* at 4.
- 12 12 U.S.C. § 24, 12 C.F.R. Part 23.
- 13 CFPB Automobile Finance Examination Procedures, *available at*
http://files.consumerfinance.gov/f/201506_cfpb_automobile-finance-examination-procedures.pdf.
- 14 *Id.* at Auto Finance 1.
- 15 June 10, 2015, CFPB Press Release, *available at*
<http://www.consumerfinance.gov/newsroom/cfpb-to-oversee-nonbank-auto-finance-companies/>.
- 16 Fed. Reg. Docket No. CFPB-2014-0024 at 90, 92.
- 17 *Id.* at 81.
- 18 See Dec. 20, 2013 CFPB Press Release, *available at*
<http://www.consumerfinance.gov/newsroom/cfpb-and-doj-order-ally-to-pay-80-million-to-consumers-harmed-by-discriminatory-auto-loan-pricing/>; see also CFPB Supervisory Highlights:
Summer 2014, *available at* http://files.consumerfinance.gov/f/201409_cfpb_supervisory-highlights_auto-lending_summer-2014.pdf (describing the CFPB's fair lending supervisory activity
in auto lending).

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