The Daily Dish

Congressional Rebuke of CFPB Methods

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Eakinomics: Congressional Rebuke of CFPB Methods

On Tuesday, in a partisan (234-175) vote, the House passed S.J. Res. 57, thus using the Congressional Review Act (CRA) to roll back the Consumer Financial Protection Bureau's (CFPB's) auto lending restrictions. Since the resolution previously passed the Senate and President Trump supported it, a quick enactment is almost certainly assured. Taken at face value, the resolution rescinds CFPB rules regarding the role of auto dealers in arranging the financing of auto purchases. But the passage of S.J. Res. 57 is also a strong rebuke of the CFPB's research methods.

At issue is a situation in which an auto buyer relies on the auto dealer to find a lender to finance the car purchase. (In other circumstances, individuals could go directly to a bank to obtain financing on their own.) These arrangements often contain a base interest rate at which the lender is willing to buy the loan from the dealer, but also flexibility for the dealer to charge a higher rate. The lender then gives the dealer a portion of the higher rate as compensation for the costs of finding borrowers and originating loans. Coincidentally, this scenario creates a situation in which different borrowers could, in principle, face different interest rates on the same loan to finance identical cars. The CFPB rules were ostensibly put in place to ensure that dealers abided by the Equal Credit Opportunity Act, which makes it unlawful to discriminate (i.e., charge different rates) on the basis of sex, marital status, race, color, religion, national origin, age, or receipt of public assistance.

There were two problems. First, Section 1029 of the Dodd-Frank Act, which created the CFPB, explicitly said that "the Bureau may not exercise any rulemaking, supervisory, enforcement or any other authority, including any authority to order assessments, over a motor vehicle dealer that is predominantly engaged in the sale and servicing of motor vehicles." Clearly, Congress felt that the CFPB overstepped its authorities. The second and more important issue is the methods that the CFPB used to conclude that auto dealers were, in fact, discriminating and in need of regulation.

The CFPB's conclusion came in two steps. First, it adopted the standard of disparate impact in place of disparate treatment. In a disparate treatment case, the wronged party has to prove that there was discriminatory intent; i.e., intentional differences in treatment. Under a disparate impact standard, there is no need to prove intent. Instead, the CFPB (on behalf of the wronged consumers) merely had to show that the procedure yielded a disproportional adverse outcome on, say, minorities, regardless of lack of intent. Disparate impact is a controversial legal theory for obvious reasons.

Second, CFPB had to match interest rates charged to the race of the borrower. Since that information is not actually on the loan forms, the CFPB adopted "Bayesian Improved Surname Geocoding" — essentially an elaborate statistical guess based on last name and location. That would be fine if individuals were correctly identified with high probability. Unfortunately, they were not.

The use of the CRA to eliminate the auto lending rules is a reminder that the executive branch should be restricted to acting within the authorities provided by Congress and should apply redress only when there is a finding of actual harm.