

Industry-First Proactive Regulatory Compliance

Context

The Equal Credit Opportunity Act prohibits lenders from discriminating during any credit transaction, the Consumer Financial Protection Bureau passed rules requiring lenders to enforce this on indirectly sourced loans, in particular loans originated through an auto dealer who can apply a dealer markup – an increased interest rate whose profits are shared between the lender and the dealer.

In 2013, the CFPB ordered Ally Bank to pay \$98 million in damages and penalties over these dealer markups being applied discriminatorily. This led to many institutions enforcing hard caps or ending the dealer markup program entirely. Multiple Verde client institutions reached out for guidance.

Challenge

- ECOA prevents discrimination on the basis of age, gender, race, and other protected factors
- Indirect loan applications do not usually contain gender or race information and are usually processed without meeting the customer
- CFPB enforcement is necessarily opaque

Solution

- Analyzed court filings, public records, and CFPB publications, reverse engineering the methodology used for enforcement
- Found the CFPB relied on an approach referred to as Bayesian Improved Surname Geocoding (BISG) for racial analysis and age-adjusted given name probabilities for gender analysis.
- Implemented these systems, along with age and marital status, to provide a complete review of discriminatory behavior, both at the portfolio level, and as a per-decision metric.
- Produced reports allowing client institutions to intervene with dealers, down to the single salesperson level, to bring dealers into compliance.
- Built an automated system to limit dealer markup on a per-application level to ensure continued compliance.
- Produced automated reports, providing documentation of compliance.

Results

- Compliance reports simplified back-office reporting
- Client institutions were able to continue their dealer markup programs
- Reduced uncertainty within the enforcement of these rules