NEW YORK STATE
DEPARTMENT of FINANCIAL SERVICES

Andrew M. Cuomo
Governor

Maria T. Vullo
Superintendent

TO: Indirect Automobile Lenders

FROM: Maria T. Vullo, Superintendent of Financial Services

RE: Indirect Automobile Lending and Compliance with New York's Fair Lending Statute

DATE: August 23, 2018

The New York State Department of Financial Services (the "Department") is issuing this guidance to ensure compliance with New York State's Fair Lending Law, Section 296-a of the Executive Law ("Fair Lending Law"), by supervised institutions that engage in indirect automobile lending.[1] This continues guidance issued by the New York State Banking Department, regarding the fair lending plan requirement, fair lending plan guidelines, and indirect automobile lending by financial institutions and sales finance companies. This guidance applies to all supervised institutions and their subsidiaries and affiliates ("lenders").

New York's Fair Lending Law prohibits discrimination in, among other things, the granting, withholding, extending, or renewing, or in the fixing of the rates, terms, or conditions of any form of credit on the basis of race, creed, color, national origin, sexual orientation, military status, age, sex, marital status, disability, or familial status. N.Y. Exec. L. § 296-a(1)(b). Risk-based pricing is permissible in New York State provided that it is not tied to a protected class. *Id.* § 296-a(3). The Superintendent is authorized to enforce state and federal fair lending laws, *id.* § 296-a(8), N.Y. Banking L. § 9-d, N.Y. Fin. Servs. L. § 408(a)(1)(B), and is empowered to promulgate rules and regulations to effectuate the purposes of the Fair Lending Law, N.Y. Exec. L. § 296-a(11).

In its efforts to eliminate prohibited practices and to ensure compliance with the Fair Lending Law, the Department has long required that applicants seeking a license to be a licensed lender or sales finance company, and applicants seeking approval for a change of control of a lender, submit a satisfactory fair lending plan as part of their application.[2] The Department has set forth guidelines to help lenders manage the fair lending risks presented by indirect automobile lending.

[1] In a typical indirect automobile transaction, lenders receive and assess information about a prospective borrower from an automobile dealer or other third-party loan originator ("dealer") and, if interested in making an offer to acquire a loan from the dealer, provide the dealer with a risk-based price commonly referred to as the "buy rate." For purposes of this guidance, the term "loan" includes a retail installment contract.

[2] Excused from this requirement is any sales finance company that can demonstrate to the Department's satisfaction that its activity will be limited to the purchase of retail installment contracts or obligations and that the company is not involved in the application or underwriting processes.

As in previous guidance, the Department is providing the following list of actions that lenders should take to develop a fair lending compliance program for indirect automobile lending:

1. The lender's Board of Directors and senior management are responsible for developing a fair lending plan and ensuring that the lender's practices comply with the plan's provisions.
2. A fair lending compliance program should monitor implementation of the fair lending plan and adherence to the plan's policies and procedures by the lender. Monitoring should, on an on-going basis, address both the lender's application and underwriting processes and its pricing policies.
3. The fair lending plan should include a training program for both new hires and current employees, including management and other key personnel. At least semi-annually, lending personnel should receive updates on fair lending issues. Compliance personnel should administer and conduct the training program and participants should certify that they understand and commit to upholding the principles of fair lending laws and the policies and procedures contained in the fair lending plan.
4. All consumer applications for a loan that are rejected or withdrawn should receive an automatic and timely review by a higher-level supervisor.
5. The principles of the fair lending plan should extend to the lender's refinancing and collection practices.
6. The fair lending compliance program should identify actions taken to demonstrate that the lender has taken the appropriate measures to extend the policies and procedures of the fair lending plan to third-party originators of the credit transaction, namely dealers. The lender should obtain written agreements from all dealers with which it has relationships that certify that the dealer acknowledges its responsibility to comply with fair lending laws and the policies and procedures contained in the fair lending plan, to the extent such policies and procedures are applicable to them. Such agreements should be updated regularly.
7. The lender's fair lending compliance program and fair lending plan should periodically be reviewed and updated, including by senior management, to ensure that they remain current.

Liability of Lenders for Discrimination Resulting from Markup and Compensation Policies

Like any third-party origination relationship, indirect automobile lending or leasing carries with it the potential for compliance issues due to the actions of the third party. One area of concern for the Department is the potential misuse of the discretion granted to dealers by lenders in the credit transaction.

It has come to the Department's attention that many lenders permit dealers to exercise discretion and add to the buy rate a "dealer markup" or "dealer overage." The dealer is paid, in whole or in part, the difference between the buy rate and the higher interest rate ultimately charged to the consumer. Dealer markup is an additional source of compensation for dealers. The lender may also receive a portion of the dealer markup. Lenders that permit dealers to markup the buy rate and establish policies governing the amount and availability of dealer markup are potentially liable for pricing disparities on a prohibited basis.

Because dealer markup is part of the credit transaction, it must be charged nondiscriminatorily to comply with the Fair Lending Law. Accordingly, the Department recommends the following compliance actions to address these risks:

1. The lender should learn about a dealer and its business practices before entering into a third-party loan origination agreement. The lender should periodically evaluate its relationship with a dealer to determine whether practices need to be revised or the relationship terminated, and make provisions for such evaluations in the lender's compliance procedures.

2. The lender should review any policies or procedures a dealer uses when arranging financing for customers and advise the dealer of any areas of weakness or concern.

3. The lender should regularly assess its and a dealer's product marketing and advertising strategies to ensure those strategies comply with the principles and provisions of fair lending laws and the fair lending plan.

4. The lender should consider reducing dealer discretion by placing limits on dealer markup, or eliminating dealer discretion to markup interest rates by using a different method of dealer compensation, such as a flat fee for each transaction, that does not potentially result in discrimination. Limits on markup do not, however, guarantee protection from fair lending liability.

5. The lender should monitor both its whole portfolio and specific dealers for compliance with fair lending policies and procedures. Depending on the size and complexity of the lender, this may require conducting regular statistical and regression analyses of loan data. These analyses can test for potential evidence of discrimination based on prohibited factors in the credit transaction and product pricing. Legitimate reasons for differences in the interest rate include differences in the credit quality between applicants or demonstrable differences in business climate at the time of the offers.

6. The lender should take prompt corrective action if it finds any differences in interest rates that are unexplained by objective credit factors, such as restricting or eliminating a dealer's ability to markup, terminating the lender's relationship with a dealer, and providing restitution to affected consumers.

The suggestions in this memorandum are non-exhaustive guidelines for developing robust fair lending compliance programs and are not intended to limit the scope or applicability of any law or regulation. The Department will continue to conduct fair lending examinations to review indirect automobile lending programs where appropriate and to take any other supervisory or enforcement actions necessary to ensure that lending in New York State is fair and nondiscriminatory.

Maria T. Vullo
Superintendent