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# Biden administration signals change in direction for subprime auto regulations

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Subprime auto lending and securitization is rolling as few thought possible at the start of the pandemic. The catalyst for the positivity has been the strength of the underlying auto market and collateral values.

## Unprecedented good times for the automobile

Despite the unemployment and economic uncertainty brought on by the COVID-19 crisis, the automobile itself has been enjoying an unprecedented level of importance in daily life. It is no longer just about freedom, sport or luxury; it now helps support the most basic human needs of health and safety and the ability to earn an income. This level of importance and ease of foreclosure translates into high priority of payment for consumers over other debt, and the asset-backed securities (ABS) market related to auto loans and leases is recognizing that.

In addition, due to short supply brought about by disruptions to manufacturing and technology, the market has basically been drinking through a straw to satisfy vehicle demand. This draw on supply and pent up demand could run on for some time even after we come out of the pandemic. Combine the factors of short supply and high priority of payment, and it all makes a bet on auto lending and ABS a good hedge against the economic crisis.

But there is a cloud over the road ahead in terms of regulatory uncertainty and expected greater enforcement activity under the Biden administration. Though the concerns may lead to higher quality pooled loans, it could also lead to additional costs in the system. Ultimately, if there are significant concerns regarding regulatory enforcement or new regulations, they could chill new originations and ABS issuances.

## Regulation and enforcement uncertainty for the market

Eye on the road ahead, there are five main areas to watch for new regulatory activity from the Consumer Financial Protection Bureau (CFPB), Department of Justice (DOJ), Federal Trade Commission (FTC) and State Attorneys General (State AGs):

1) Equal treatment. There will likely be more enforcement from the CFPB and potentially the DOJ related to fair lending and disparate impact issues under the Equal Credit Opportunity Act, which prohibits credit discrimination on the basis of race, color, religion, national origin, sex, marital status, age or receipt of public assistance. Enforcement surrounding disparate impact will address situations where business practices result in racial disparities, even if they are unintentional.

Although Congress invalidated CFPB efforts to pursue indirect auto lenders/discriminatory dealer pricing back in 2018, the CFPB could issue new guidance or rulemaking addressing fair lending. When at the FTC, Commissioner Rohit Chopra, now the CFPB Director nominee, noted several concerns within the auto market including dubious repossession and financing tactics, which could become the focus of the CFPB.

2) Unfair practices. The market should expect broader enforcement against unfair, deceptive or abusive acts and practices (UDAAP) by the CFPB and unfair and deceptive acts and practices (UDAP) by State AGs, which prohibit such activities in connection with a consumer financial product or service or the offering of a consumer financial product or service. Guidance on what constitutes "abusive" conduct has changed with the new administration.

The CFPB rescinded the 2020 guidance on "abusive acts and practices" from the previous administration. In the first post-Kathy Kraninger lawsuit brought by the CFPB in late February 2021, it pursued an immigrant bond company, calling the use of an English language agreement in a situation where the clients did not understand English to be "abusive," and under the Acting Director, Dave Uejio, the CFPB is already pursuing other service providers under "abusiveness" standards.

3) Fair collection. The Fair Debt Collection Practices Act, which prohibits debt collection companies (not the original creditor) from using abusive, unfair or deceptive collection practices, is bound to see a revival under Democrat-led CFPB and split-party FTC.

Years in the making, the CFPB Debt Collection Rules were scheduled to go into effect on Nov. 30, 2021 (although the CFPB is now moving to delay implementation of the rules until January 2022) and subject new technologies and social media to regulation. In addition, the economic stress of the pandemic has put servicing practices under stricter scrutiny and could lead to more rulemaking and enforcement in this area. It's even possible that the Obama-era CFPB desire to expand restrictions to first-party creditors will get a

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second look during the Biden administration, but new regulations would not happen fast.

4) Fair reporting. The market could see more enforcement activity by the CFPB and FTC under the Fair Credit Reporting Act (FCRA) and the credit reporting elements of the Coronavirus Aid, Relief, and Economic Security Act of 2020 (CARES Act). Given heightened sensitivity to the plight of the unemployed in the pandemic, creditors will need to pay close attention to credit reporting requirements of the CARES Act for accounts in accommodation or delinquency and ensure they are communicating accurately with consumers.

Separately, there could be more actions similar to the CFPB consent order ($4.75M fine) against Santander late in 2020 for a violation of the FCRA related to furnishing incorrect information to credit reporting agencies, failing to update incomplete information, failing to provide the fate of direct delinquency and failing to establish and implement reasonable written policies and procedures regarding information provided to credit reporting agencies.

5) Usury limits on interest. State usury caps have come back in the spotlight in recent years, especially in marketplace and online lending, requiring financial institutions and fintechs to understand the local restrictions that may apply to bank partnership lending models.

Although usury laws are as old as the alphabet (and not so simple to follow), new updated laws should be expected to better address current consumer protection concerns. For example, in an effort to address predatory lending issues Illinois recently passed a new law that puts an interest rate cap on all new consumer loans including open-end and closed end installments, payday, and motor vehicle RICs (Retail Installment Contracts) unless those are made by banks, savings and loans, credit unions, or insurance companies.

The new law puts in place a 36% "all in" APR rate cap. The "all in" component requires that the calculation include finance charges, application fees, credit insurance premiums or fees, any fees for a credit-related ancillary product sold in connection with the credit transaction. This essentially brings the state law in line with the federal Military Lending Act.

## Where does the road lead?

In the auto lending space, it will not be surprising for heightened regulatory scrutiny to be born out of the increased importance consumers place on their vehicles. A major focus for government agencies and State AGs will be to protect the most vulnerable of consumers, represented in large part by the subprime credit class. The question is, how far will consumer protections go?

We have already seen at least one State AG pursue a major lender for making loans it claimed the lender was aware borrowers could not repay. Broader application of this "ability to pay" standard, a requirement in the mortgage lending space, could have a chilling effect on subprime lending, all at a time when consumer demand is so high for the benefits of vehicle ownership.

Clear regulations and enforcement policies will be needed to provide lenders and other market participants with clarity. Access to credit among the most underserved consumers may be severely impacted should lenders fear legal exposure under new, uncertain standards.

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