Consumer Financial
Protection Bureau

SUPERVISORY LETTER

Review Start Date:	**September 10, 2012**
Entity name:	**Ally Bank**
City, State:	**Detroit, MI**
CFPB Docket Number:	[redacted]
CFPB Region:	**Northeast**

Entity Type:	**Depository Institution**
Review Type:	**Target Review**
Subordinate and Affiliated Organizations Reviewed:	**Ally Financial, Inc.**

Prohibition of Disclosure or Release

This document is the property of the Consumer Financial Protection Bureau (CFPB), and the CFPB furnishes this document to the entity for its confidential use. The entity's directors, officers, or employees may not disclose the report or any portion of it except as provided in 12 CFR Part 1070.

If the entity receives a subpoena or other legal process calling for production or testimony regarding this document, notify the Regional Director and the CFPB General Counsel immediately. Advise the party issuing the subpoena and, as appropriate, the court of the above prohibition and refer them to 12 CFR Part 1070.

Table of Contents

Review Conclusions

Scope

Summary

The Consumer Financial Protection Bureau (CFPB) conducted a targeted review of Ally Bank (AB) and Ally Financial Inc. (AFI), its non-bank subsidiary (collectively, Ally), both of which are engaged in indirect automobile lending, for compliance with fair lending provisions of the Equal Credit Opportunity Act (ECOA) and its implementing Regulation B. The review commenced on September 10, 2012, and ended on November 2, 2012.

The scope included pricing and underwriting analyses of Ally's indirect automotive lending portfolio. The analyses were based on automobile loan applications received and/or booked between April 1, 2011, and March 31, 2012. There were [redacted] applications reported and [redacted] booked loans during that period. The booked transactions that were analyzed involved [redacted] unique dealers with [redacted] dealers accounting for [redacted] percent of the volume by amount financed. In addition to statistical analysis, the scope included interviews with [redacted] underwriters, discussions with business line management, reviews of underwriting and pricing policies, fair lending policies, and training. Examiners also reviewed Ally's compliance management system (CMS) with respect to fair lending in the consumer automotive line of business.

Proxy Methodology - Surrogate for Prohibited Basis Group Characteristic

12 CFR Section 1002.5(b) prohibits lenders from requesting information about the applicant's race, national origin, and sex for credit transactions that are not for the purpose of purchase or refinancing the applicant's principal dwelling and secured by that dwelling. Consistent with this regulation, the indirect auto loan dataset provided by Ally did not contain information on the applicant's race, ethnicity, or sex. However, in order to conduct pricing and underwriting analyses, the CFPB used a proxy methodology for assigning race, ethnicity, and sex to applicants based on reported address information and name. Applications for which a geography or name based proxy could not be assigned were excluded from the analysis.

Pricing Analysis

The pricing analysis focused on dealer ~~mark-up~~markup, which is the difference between the final contract rate paid by the borrower and the rate at which Ally purchased the contract (buy rate~~buy-rate~~). The initial analysis pointed to higher dealer markups ~~mark-ups~~ for African-Americans, Hispanics, and Asian-Pacific Islanders compared to non-Hispanic Whites. To evaluate these disparities in markup, a sample of 145 loans to borrowers identified as likely to be African-American or Hispanic was selected for comparative file review. Each of the 145 files was paired with a similarly situated loan to a borrower identified as likely to be non-Hispanic White.

In addition to dealer ~~mark-up~~markup, the CFPB performed an evaluation of other potential pricing disparities across race, ethnicity, and sex, including ~~buy-rates~~buy rates (lender's interest rate quoted to dealers), rate shaves (downward adjustments made by Ally to the ~~buy-rate~~buy rate), and tier bumps (adjustments made by Ally to its proprietary credit scoring system to lower the ~~buy-rate~~buy rate).

Underwriting Analysis
The underwriting analysis focused on applications that were initially declined by Ally's automated system, but later reversed to "qualified" by the underwriter (low-side exceptions). The initial analysis revealed a low percentage of underwriting exceptions being applied to denied Hispanic and African-American applicants compared to non-Hispanic White applicants.

To determine whether the disparities in the proportion of low-side exceptions for African-Americans and Hispanics could be explained by factors outside the statistical model, a sample of 114 applications from individuals identified as likely to be African-American or Hispanic were selected for comparative file review. Each of the 114 files was paired with an application from an individual likely to be non-Hispanic White that was initially denied and subsequently deemed "qualified."

Conclusions and Comments

The fair lending review revealed statistically significant disparities in pricing across race and ethnicity in violation of ECOA, 15 U.S.C. §§ 1691-1691(f), and its implementing regulation, Regulation B, 12 CFR pt. 1002. The CFPB found statistically significant disparities in dealer markups between prohibited basis group applicants and control group applicants. Specifically, African-American, Hispanic, and Asian-Pacific Islander borrowers paid higher average dealer markups than non-Hispanic White borrowers.~~, as indicated in the CFPB's Potential Action Response Request (PARR) letter dated January 15, 2013.~~

Ally's policy permits purchase of retail installment sales contracts with interest rates up to [redacted] basis points higher, depending on the term of the loan and, for borrowers [redacted], than Ally's ~~buy-rate~~buy rate and compensates dealers with the interest revenue from that markup. As a result, dealers may mark up the contract interest rate over Ally's ~~buy-rate~~buy rate. Ally's specific ~~mark-up~~markup and compensation policy has resulted in a discrimination against African-Americans, Hispanics, and Asian-Pacific Islanders in the pricing of loans in its indirect automobile financing in violation of ECOA.

Fair lending risk is exacerbated as Ally had not developed and implemented a comprehensive fair lending monitoring and testing program for consumer auto finance as of the date of this review, [redacted] During the early stages of the review Ally indicated a monitoring and testing program was under development, but based on a claim of attorney-client privilege, the company only provided a brief outline to examiners.

During a meeting on March 21, 2013, Ally did reveal and discuss with the CFPB its consumer automotive fair lending program and shared a document entitled *Pilot Monitoring Program for*

Dealer Finance Income[1] the following day. While management's efforts to design and implement a program are acknowledged, the discussions and a review of the document indicate that substantial work remains to develop and implement an effective program.

While ~~T~~the CFPB's initial statistical analysis determined that, compared to non-Hispanic Whites, African-Americans and Hispanics were not as likely to receive an underwriting exception after initially being denied, the underwriting analysis did not find evidence of discrimination. Examiners determined that there were reasonable explanations for the statistical disparities from the comparative file review, discussions with management, and interviews with underwriters.

However, ~~In addition,~~ examiners noted insufficient documentation of underwriting and pricing exceptions. The lack of sufficient documentation complicates fair lending analysis and monitoring as disparities may be more difficult to explain, which prevents the board of directors (board) and senior management from fully understanding the fair lending risks associated with Ally's automotive lending operation. [redacted]

These violations and fair lending monitoring weaknesses identified in the course of the review, any additional violations that might be identified, and any additional corrective action will be addressed separately from this letter. Furthermore, we continue to evaluate whether the Bureau will refer to the DOJ the ECOA violations identified in the course of this examination, which may result in additional corrective action by the DOJ and/or the CFPB. Please note that the CFPB's referral of a matter to the DOJ pursuant to the ECOA would be in addition to the CFPB's independent supervisory and enforcement authority to seek appropriate legal or equitable relief. Thus, a referral would not deprive the CFPB of its authority to take additional, independent corrective or formal action.

/s/ Ken Shim

Examiner-in-Charge

[1] The document [redacted] hads not been adopted.

Matters Requiring Attention

Specific expectations and time frames for actions requiring prompt response and corrective action.

The violations identified in the course of this review, any additional related violations that might be identified, and any corrective action, including remediation, will be addressed separately from this letter.

Review and Findings

Compliance Management Review

The effectiveness of the supervised entity's strategy for identifying and managing inherent risks and the strength of the entity's overall system of compliance management.

The CMS review was limited in scope to systems and processes in place to monitor fair lending risk in the consumer automotive line of business.

Conclusion

Ally's consumer automotive line of business CMS is weak as CFPB believes that Ally's program is inadequate to identify potential dealer ~~mark-up~~markup disparities or sufficiently mitigate fair lending risk.

Comments and Supporting Analysis

The consumer automotive section of Ally's *Fair Lending and Consumer Practices Program* (Auto Fair Lending Program)[2] contains certain underwriting and pricing controls, most notably the [redacted] basis point dealer markup cap for installment sales contracts with a term of five years or fewer and a [redacted] basis point dealer markup cap for installment sales contracts with a term of greater than five years, as well as other controls with respect to credit denials and marketing. Prior to the review, the Auto Fair Lending Program also contemplated annual monitoring and testing routines to determine whether fair lending risk in the consumer auto finance business is stable, decreasing, or increasing; however, unlike for the consumer mortgage line of business, statistical analysis of the consumer automotive portfolio using regression analysis and other modeling techniques was not contemplated.

During the review, management indicated that a statistical analysis program for the consumer automotive portfolio was under development, but details of this program were not shared with the CFPB until a March 21, 2013 meeting. During that meeting, Ally management described its program under development and the provided a document entitled *"Pilot Monitoring Program for Dealer Finance Income"* (Dealer Monitoring Program) after the meeting. The document had not yet been approved [redacted] CFPB representatives also met with Ally officials on March 27, 2013, May 28, 2013, and June 28, 2013, at which fair lending issues in the automotive line of business were discussed, including the Dealer Monitoring Program. Although the CFPB acknowledges Ally's efforts to establish its Dealer Monitoring Program, we do not believe, based on a review of the document and representations of management at the previously noted meetings, that Ally's program will satisfactorily identify potential dealer markup disparities or sufficiently mitigate fair lending risk.

[2] The program was adopted effective April 1, 2012. [redacted]

Required Corrective Actions

To address weaknesses in managing risks of potential unfair, deceptive, or abusive acts or practices; of discrimination; or of other violations of Federal consumer financial law.

~~Management must complete and implement an effective fair lending monitoring program for consumer automotive operations no later than January 31, 2014.~~
The violations identified in the course of this review, any additional related violations that might be identified, and any corrective action will be addressed separately from this letter.

Area Reviewed: Fair Lending - Indirect Automobile Lending

Conclusion

The fair lending review revealed disparities in pricing across race and ethnicity in violation of ECOA, 15 U.S.C. §§ 1691-1691(f), and its implementing regulation, Regulation B 12 CFR pt. 1002. The pricing statistical analysis conducted by the CFPB revealed that African-American, Asian-Pacific Islanders, and Hispanic applicants paid on average higher markups compared to non-Hispanic White applicants. This violation and any additional violations that might be identified in the course of the review and any additional corrective action will be addressed separately from this letter.

The CFPB's underwriting analysis did not find evidence of discrimination. Our statistical analysis of low-side exceptions indicated that African-American and Hispanic applicants received low-side exceptions less frequently than non-Hispanic White applicants. However, from the comparative file review, additional information provided by management, and interviews of [redacted] underwriters, we concluded that there were satisfactory explanations for the low-side exceptions. Examiners also concluded that all [redacted] underwriters are adhering to Ally's pricing and underwriting policies uniformly.

Comments and Supporting Analysis

Pricing Analysis

~~The pricing analysis revealed that Hispanic and African-American credit applicants paid higher dealer markups compared to non-Hispanic White applicants for both subvented and non-subvented loans. Asian-Pacific Islanders paid higher dealer markups compared to non-Hispanic White applicants for non-subvented loans only. The amounts of the disparities are statistically significant. The disparities are discussed in greater detail in the CFPB's PARR letter dated January 15, 2013.~~ Our markup analysis focused on the interest rate difference between each borrower's contract rate and Ally's buy rate. We analyzed the amount of markup separately for non-subvented loans and subvented loans over a one-year period from April 1, 2011 to March 31, 2012. We identified the following statistically significant average disparities in dealer markup:

- 29 basis points between similarly situated African--Americans and ~~N~~non-Hispanic Whites in non-subvented loans.
- 20 basis points between similarly situated Hispanics and ~~N~~non-Hispanic Whites in non-subvented loans.

- 21 basis points between similarly situated Asian-~~/~~Pacific Islanders and n~~N~~on-Hispanic Whites in non-subvented loans.
- 22 basis points between similarly situated African--Americans and ~~N~~non-Hispanic Whites in subvented loans.
- 14 basis points between similarly situated Hispanics and ~~N~~non-Hispanic Whites in subvented loans.

Ally maintains a discretionary dealer ~~mark-up~~markup policy with a [redacted] basis point cap for loan terms of more than 60 months and a [redacted] basis point cap for terms of 60 months or less.[3] When the CFPB commenced this review, Ally's fair lending program did not include monitoring of dealer ~~mark-ups~~markups to ensure compliance with fair lending laws. Although the business line compliance team monitors ~~mark-ups~~markups, the purpose is to identify and prevent dealers from exceeding the cap.

To determine whether the disparities in ~~mark-up~~markup are due to legitimate considerations justified by business needs. ~~to characteristics not accounted for by the statistical model.~~ examiners compared 145 loans to African-American and Hispanic borrowers to one or more loans to non-Hispanic White borrowers. Based on the comparative file review, examiners could not determine non-discriminatory reasons for the disparities in the dealer markups and management was unable to provide explanations for the disparities.

The CFPB also conducted additional pricing analyses including buy rates, rate shaves, and tier bumps. The analyses did not find evidence of discrimination across race, ethnicity, or sex.

Underwriting [redacted]
The underwriting analysis did not find evidence of discrimination. The CFPB's initial statistical analysis determined that, compared to non-Hispanic Whites, African-Americans and Hispanics were not as likely to receive an underwriting exception after initially being denied. However, examiners determined that there were reasonable explanations for the statistical disparities from the comparative file review, discussions with management, and interviews with underwriters.

Documentation of Pricing and Underwriting Exceptions.
During the comparative file review, examiners noted insufficient documentation of the application of underwriting and pricing exceptions contemplated under Ally's credit policies. Underwriter notes in the [redacted] system were insufficiently detailed to fully understand the reason for the exception. The lack of sufficient documentation complicates fair lending analysis and monitoring as disparities may be more difficult to explain, which prevents the board and senior management from fully understanding the fair lending risks associated with its automotive lending operation. [redacted]

[3] For Ally's lowest credit tiers, the markup cap was [redacted].

Required Corrective Actions

Management must effect the following corrective actions:

- These violations of 12 CFR Section 1002.4(a), any additional violations that might be identified, and any additional corrective action will be addressed separately from this letter.
- Improve underwriter documentation of pricing and underwriting exceptions and submit a plan to the CFPB for effecting improvement exception documentation.

Compliance with Supervisory or Enforcement Actions

The status of the supervised entity's compliance with consumer financial protection-related supervisory or enforcement actions, including any areas of non-compliance or partial compliance.

N/A

Appendix

CFPB Review Team Members

The following individuals participated in this review:

Name	Title
[redacted]	[redacted]
[redacted]	[redacted]
[redacted]	[redacted]
[redacted]	[redacted]
[redacted]	[redacted]
Donald Groves	Field Manager