CRA Insights

CRA Charles River Associates

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Fair lending considerations for auto finance payment deferrals related to COVID-19

Key takeaways

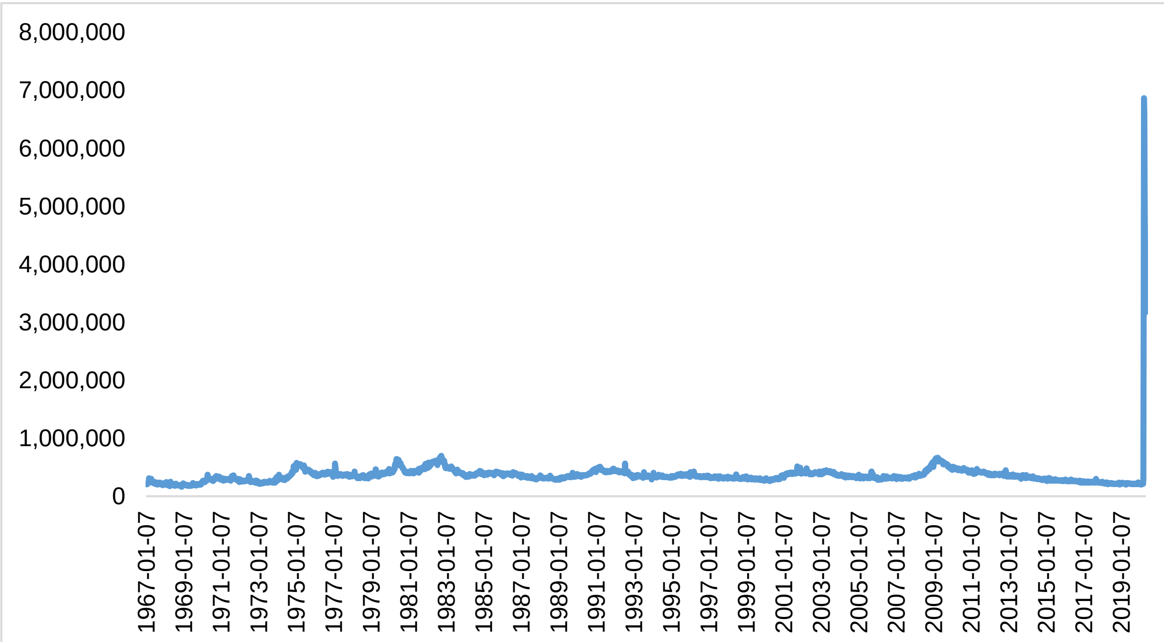
Many auto finance providers have responded to the COVID-19 crisis by offering deferred payment options and other forms of financial assistance to their borrowers. Because these policies were created under significant time and resource constraints, auto finance providers should be especially prudent in considering any fair lending risk that they may create. In particular, they should evaluate:

1. The degree of judgment involved in their deferment process and whether the lack of a universal deferment policy could lead to differential outcomes across protected classes,
2. The factors considered in allowing or disallowing deferment and whether these factors have a sufficient business justification,
3. The methods by which different borrowers are alerted of their deferment options and whether these methods could result in disparate treatment for different groups, and
4. Their capacity to electronically store the factors used in making decisions on individual borrowers so statistical fair lending testing can be done quickly and easily.

Background

As the COVID-19 crisis continues to upend nearly all facets of the US economy, millions face job loss and increased financial insecurity. The COVID-19 pandemic is unique for both its severity and its arrival speed. From March 8 to May 2, 2020, 33.8 million Americans made an initial unemployment claim, representing an increase of 1,888% over the 1.7 million Americans who filed initial claims over the previous eight-week period. As shown in Figure 1, this is the largest increase since weekly data reporting began on January 7, 1967. Figure 1 shows the seasonally adjusted initial claims for unemployment benefits.[1] The economic shock has already impacted many auto finance companies. These companies have already allocated millions of dollars to cover anticipated credit losses for their auto portfolios or have delayed earnings reports due to the crisis.[2]

Figure 1: Initial unemployment claims, number, weekly, seasonally adjusted



Source: US Employment and Training Administration, Initial Claims

Actions taken by auto finance providers

The severe shock from the COVID-19 pandemic, coupled with delinquency rates that were already increasing at the end of 2019, has caused auto finance providers to offer deferred payment programs and other efforts designed to mitigate the expected financial damage due to missed payments on auto contracts.[3] These programs and options include:

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1 US Employment and Training Administration, Initial Claims (ICSA), retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/ICSA, May 18, 2020.

2 See, e.g. Shiho Takezawa and Tsuyoshi Inajima, "Nissan Warns of Losses, Delays Earnings Report Due to Pandemic," *Bloomberg*, April 28, 2020. https://www.bloomberg.com/news/articles/2020-04-28/nissan-warns-of-lower-profits-delays-earnings-report-to-may-28; Nicole Casperson and Joey Pizzolato, "JPMorgan Chase, Wells Fargo Hunker down for Increased Credit Losses," *Auto Finance News*, April 14, 2020. https://www.autofinancenews.net/allposts/finance/loss-mitigation/jpmorgan-chase-wells-fargo-hunker-down-for-increased-credit-losses; Jackie Charniga, "Ally Q1 hard-hit from COVID-19; 25% of auto customers seek forbearance," *Automotive News*, April 20, 2020. https://www.autonews.com/finance-insurance/ally-q1-hard-hit-covid-19-25-auto-customers-seek-forbearance.

3 American Bankers Association, "ABA Report: Consumer Delinquencies Rise in Fourth Quarter of 2019," press release, April 15, 2020, https://www.aba.com/about-us/press-room/press-releases/aba-report-consumer-delinquencies-rise-in-fourth-quarter-of-2019.

1. Allowing customers to defer payments for up to 60, 90, or 120 days,
2. Waiving late payment fees,
3. Offering lease extensions of various lengths, and
4. Providing undisclosed additional assistance on a case-by-case basis.[4]

Mitigating fair lending risks

While auto finance providers quickly rolled out changes to provide financial relief options to customers, it is essential that these creditors evaluate the fair lending risks associated with these new policies.

When implementing payment deferral policies, the following areas may present a fair lending risk associated with discretion or potential disparate impact:

1. Requirements for receiving payment deferrals,
2. Magnitude or type of payment deferral or other relief,
3. Marketing and outreach efforts, and
4. Policies governing the post-pandemic period.

If auto finance providers have policies that include discretion, they should track the factors used to exercise that discretion and use that information to assess whether similarly situated borrowers are treated the same. Providers also need to perform statistical testing to ensure that any differences in outcomes across classes protected by the Equal Credit Opportunity Act (ECOA) can be explained using policy-based factors that inform the application of judgment.

Facially neutral policies, even if applied in an automated way, may present a fair lending risk if they result in differential outcomes across protected classes. Auto finance providers should evaluate the policy criteria they are using, including marketing and outreach efforts, to ensure the criteria are objective, have a sufficient business justification, and do not create a disparate impact. It is advisable to track metrics like opt-in rates or approval rates to get a sense of the potential disparate impact of chosen policies. This would allow providers to quickly change policies if they need to reduce observed potential impact, even if a complete analysis needs more time to be completed.

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[4] See, e.g. Ally Financial, "Ally Introduces Relief Package to Support Customers, Auto Dealers, Communities, and Employees During Global COVID-19 Crisis," press release, March 18, 2020, https://media.ally.com/2020-03-18-Ally-Introduces-Relief-Package-to-Support-Customers-Auto-Dealers-Communities-and-Employees-During-Global-COVID-19-Crisis; Ford, "Committed to Lending a Hand, Ford Offers Assistance to US Customers and Communities during COVID-19 Outbreak," published March 16, 2020, https://corporate.ford.com/articles/products/ford-offers-assistance-customers-communities-during-covid-19.html; and Chase, "Chase Auto Loan and Lease Customers," accessed April 10, 2020, https://www.chase.com/digital/resources/coronavirus/auto-lending.

About the Financial Economics Practice at CRA

Our consultants provide economic and financial analysis and advice to financial institutions, financial regulators, and counsel representing financial institutions. Our experts are skilled in quantitative modeling and econometrics, particularly as applied to issues in credit and compliance risk in consumer lending markets. We provide fair lending analyses of underwriting, pricing, and servicing practices for use in litigation and regulatory investigations. We also provide ongoing statistical monitoring of fair lending risk, including monitoring required under the terms of consent orders with federal government agencies.

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