SubPrime Auto Finance News

January + February 2019 | Volume 14 | Issue 1

Compliance update

Kathy Kraninger takes control of the CFPB

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20 Money matters: Three major accounting changes to watch

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SubPrime Auto Finance News

How the CFPB continues to resemble a circus or soap opera

JOEL KENNEDY

Thanks to a continual onslaught of data breaches at banks, financial institutions and credit bureaus, consumer data security and data protection will definitely take a front-seat in the conversation.

SAN DIEGO — Richard Cordray, the first director of the Consumer Financial Protection Bureau, has been out of the picture for more than a year. His greatest accomplishment could be taking an otherwise boring, administrative government organization and forging it into a broad-sword of political polarization. His failed Ohio gubernatorial bid means he will be banished to the political version of the "phantom zone" where he will need to rely on his powerful Jeopardy skills to mount an escape.

His replacement Mick Mulvaney had to win a hard-fought court battle (English versus Trump) before even being allowed to serve as the acting director. Recently, Mulvaney increased his political power by being named by Trump as acting chief of staff. Mick likes jobs with the title "acting" so much! He gets to spend every day acting like he is not working for a "terrible human being" that would be disqualified from holding office in an "ordinary universe" – both actual Mulvaney quotes that according to Mick are something that he and Trump giggle about while chasing each other around the Oval Office with the new Nerf blasters they got for Christmas.

So, we now have an actual second director of the CFPB with Kathy Kraninger. Her years of experience in various government offices informed her first power move: killing the name change from CFPB to BCFP. This power move is up there with George Costanza reorganizing the Penske File, and equally as substantive. But, let's not be too tough on Kraninger. To get the role as director, she had to get past Sen. Elizabeth Warren and never say the words "yes" or "no," while accusing Kraninger of possessing ALL of the Infinity stones AND having them in a secret Infinity Gauntlet that will allow her to eliminate half of the CFPB staff with a simple snap of her finger. Warren left the interaction so incensed that her only reasonable next step (beyond cursing under her breath and practically ripping the microphone out of the podium) was to write a letter to Kraninger politisplaining to her how to do her job, and form an exploratory committee for a presidential run. Take that Kathy!

I am no James Lipton, but this stuff is so easy to turn into a script for a crummy soap opera with minimal effort. What is important for the financial services industry, the consumers we serve, and the politicians and regulators is that we get an agenda. While we can never divorce the political theatrics from the reality of what the U.S.
really needs to be done, we can take a stab at decomposing that situation. We will start with a review of the key data points that are tracked by the CFPB, and explore the points raised by both sides that will likely drive the agendas of the Dems and GOP, and try to make sense of a possible direction for 2019.

CFPB trends on auto lending

The CFPB maintains market dashboards of consumer credit trends, one of which is one on

Source: CFPB Consumer Credit Panel

auto loans. The most recent snapshot lists a 7.3% increase in year-over-year originations (July 2017 to Jul 2018) with a 2.8 percent increase in year-over-year credit tightness (Feb 2017 to Feb 2018). By all measures presented by the bureau, 2017 was a year of contraction, with 2018 showing a quick reversal of trend.

Volume

When looking at total originations (units), there was a history of dips in Jan, and spikes in March, May, and August. From 2012 to 2016 we were seeing some nice higher Jan lows and higher March, May, and August highs. The May and August volume bumps were playing a greater role in driving seasonal bumps than even the March tax season bump. That trend reversed in 2017, most profoundly in a hard drop in the Aug bump that went from a high of nearly 2.5 million down to 2.35 million in August of 2018. That trend corrected in 2018 and while we saw a lower January low, we saw higher March, May and August highs than 2017 results.

Lender credit risk

The CFPB created a credit tightness index, which is a ratio of the number of consumers who applied for credit and did not obtain the requested credit. The applicant scores are held constant, making this a measure of lender policies. We see the tightening of credit continue from the 2009 starting point (initialized at 100) down to 76.5 in May of 2015, and slowly creeping back up to 82.48 as of February 2018 and showing a positive trend with higher highs and higher lows form that low point.

When considering the credit quality (as measured by credit score) of those receiving credit, the CFPB tracks lending activity (as measured in aggregate dollars) for various categories. Deep subprime through subprime saw a pull-back starting in spring/summer of 2015, near-prime and prime saw smaller pull-backs in middle-to-late 2016, and the positive trend for super-prime has maintained without a retrace. For 2018, deep subprime volume appears to be continuing, while subprime is revisiting 2015 levels showing some higher highs and higher lows. Credits north of these ranges appear to be continuing or turning bullish.

Financial inclusion

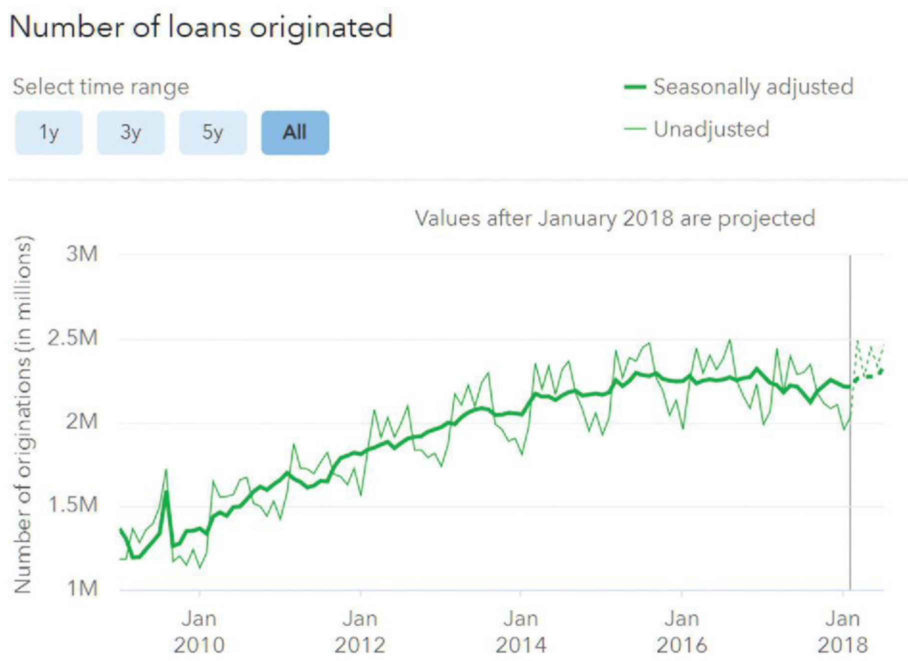
Finally, the CFPB takes a look at access to credit based on neighborhood income levels. As an aside, I personally find this statistic to be a better pulse on financial inclusion than the Bayesian Improved Surname Geocoding (BISG) statistic that has been flatly discredited. The good news for this statistic is that across all income levels we are seeing positive trends indicating increased access to credit for all income groups and geographies.

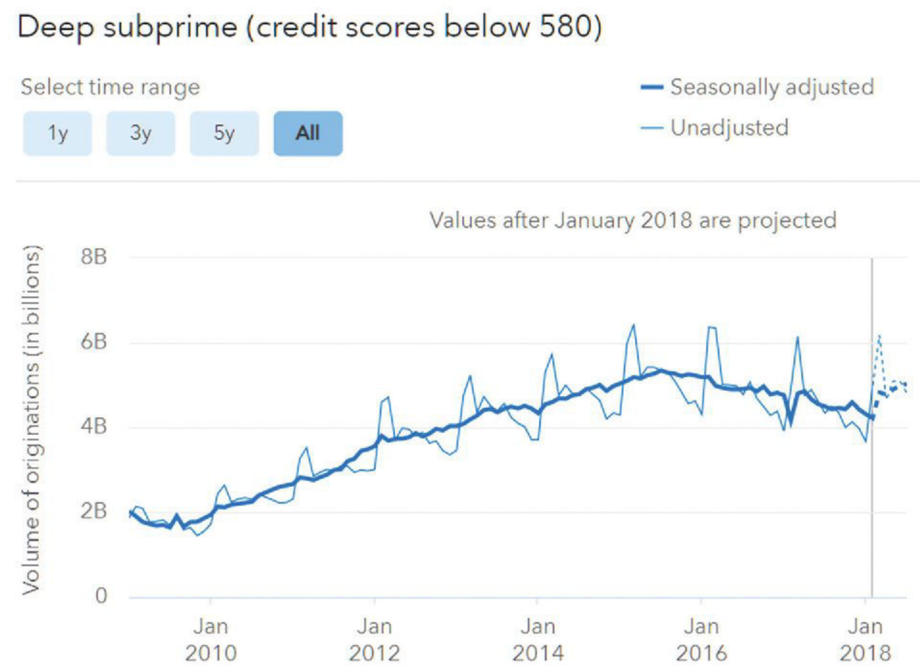
To summarize the CFPB statistics, origination volumes, credit availability, and lender management of risk all appear to be trending positive in spite of some pull-backs in 2015 and 2016, and most profoundly in 2017. The credit tightening that closed the door to many lower-tier credit seekers post 2009 is trending positively again and appears to be ranging to find a settling point that does not appear to be anywhere near the 2009 levels.

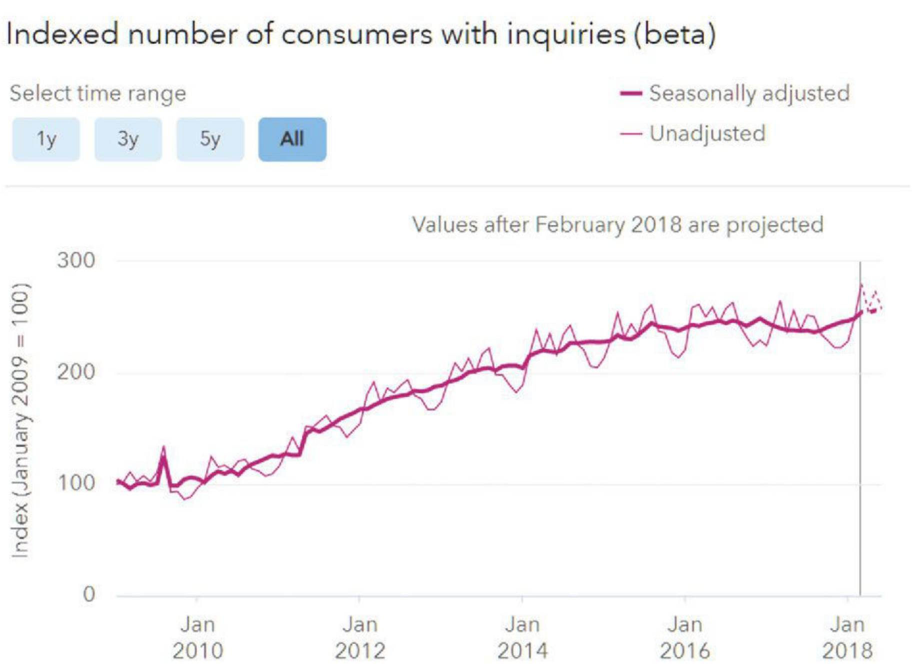
What Democrats want

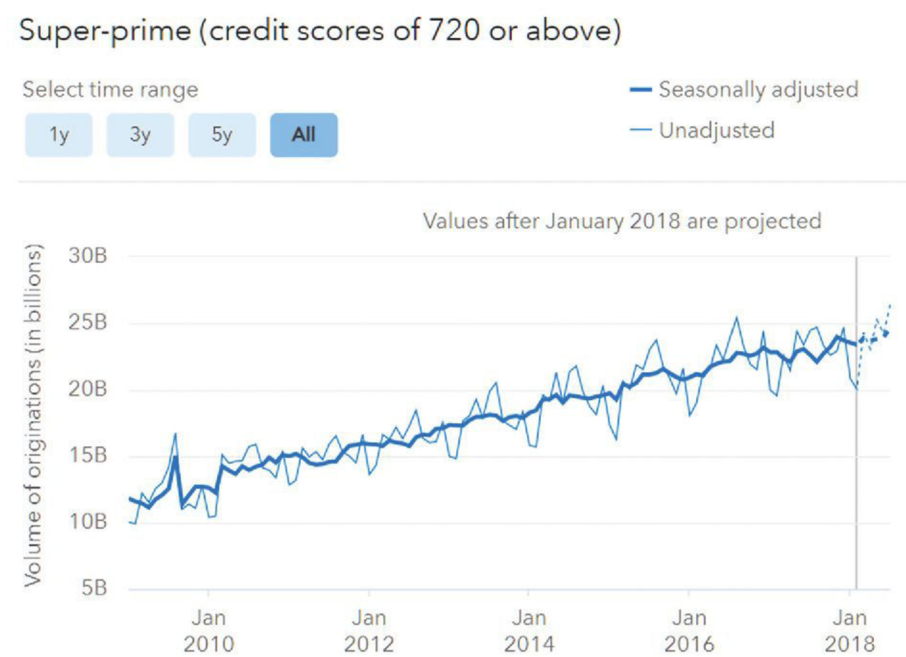
In a recent letter from Warren (dated Dec. 19) to Kraninger, Warren outlines what she believes Kraninger needs to do. Warren wants to see more fair lending enforcement actions and roll back changes that weakened antidiscrimination protections, keep the pressure on companies with aggressive data collection and continue a broad net approach to soliciting consumer complaint data, and reverse Mulvaney's changes to student and military lending regulation and oversight. While not directly stated, it is safe to say that. Warren misses Cordray's "regulation through enforcement" policies.

By all indications, the points raised by Warren are the same that Rep. Maxine Waters, the Democrat from California, will fight for as the chair of the House Financial Services Committee. Hill insiders are predicting investigations into prior Mulvaney's connections with financial services firms and the changes that he made while running the bureau. No doubt whatever is uncovered will have to be answered to by Kraninger, and if the benchmark set by prior chair Rep. Jeb Hensarling (R-Texas) holds up, Kraninger should expect to be called to testify quite a lot. The Democrats will surely look to monopolize on political theatrics to use as fodder to whittle away Republican control









Source: CFPB Consumer Credit Panel

of the Senate and White house. Will they move aggressively out of the gates, or will they bide their time in hopes of taking over control of the Senate and White House?

What Republicans want

Republicans, led by Hensarling, railed against Cordray's CFPB. They attacked the structure of the bureau as unconstitutional. Banks and financial institutions have been frustrated by Cordray's regulation through enforcement, and use of the UDAAP "catch-all" as a mechanism for turning regulatory examinations into expansive data grabs and witch-hunts where whatever is shared or found is used as a weapon against you.

It is fair to say that under Mulvaney's guidance the bureau worked to correct many of the issues that drove a wedge between the bureau and the industry it regulates, leaving the heavy lifting to the state attorneys general. To many in industry, Mulvaney's changes did not go far enough. A recent letter from National Association of Federally Insured Credit Unions (NAFCU) to Kraninger outlines some themes common across the industry; clarity and guidance on UDAAP compliance, restructuring of the agency, regulatory guidance on non-bank financial companies (fin tech) and an overhaul of the consumer complaint database and process.

The CEO of NAFCU received a phone call from Kraninger the day after the letter was delivered — something that would be impossible to imagine during the Cordray administration.

Where are we headed?

So, to review, auto lending industry statistics direct from CFPB don't show any major signs of increased risk or over-heating, and severe credit tightening is recovering. Without some obvious crisis or something you can demonstrate with data there exists no impetus for drastic action. A similar case will have to be made by other financial services markets — particularly student and pay-day lending, both of which are in the crosshairs for now, and something that is not beyond the reach of a ton of political theatrics.

Thanks to a continual onslaught of data breaches at banks, financial institutions and credit bureaus, consumer data security and data protection will definitely take a front-seat in the conversation. This is an area that is easy to find bi-partisan common ground, with winners on both sides and losers on neither.

Finally, Kraninger's term is five years, which starts upon the date of her appointment (not the date of Cordray's resignation). If the CFPB's constitutionality litigation finds its way before the Supreme Court (seen as likely within the next one to two years) then a Democratic president could have her removed without cause prior to the end of that five-year term. Even under the scenario that the Supreme Court finds the structure to be unconstitutional, Kraninger has the better part of two years to continue an agenda of making the agency more sensible and accountable.

Joel Kennedy is chief operating officer of Tru-Decision. As National Automotive Finance Association board member, he is passionate about growing and improving auto finance ecosystem. He has more than 23 years' experience helping big banks down to start-up finance companies to build, grow, improve, and repeat. He can be reached at (240) 308-2169 or joel.kennedy@tru-decision.com.