***Moving the Metal: The Auto Finance Podcast* — The Larger Participant Rule: A New Route for Auto Finance**
Hosts: Brooke Conkle and Chris Capurso
Guest: Chris Willis
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Brooke Conkle:

Welcome to *Moving the Metal*, the premier legally-focused podcast for the auto finance industry. I'm Brooke Conkle, a partner in Troutman Pepper Locke's Consumer Financial Services Practice group.

Chris Capurso:

And I'm Chris Capurso, an associate in Troutman Pepper Locke's Consumer Financial Services Practice group.

Brooke Conkle:

Today, we'll be joined by the Podfather, Chris Willis, to talk about the CFPB's proposed changes to the larger participant rule for auto finance. But before we jump in, let me remind you to please visit and subscribe to our blogs. We have two great ones that may be of interest to you, TroutmanFinancialServices.com and ConsumerFinancialServicesLawMonitor.com. And also, we have a bevy of other podcasts you might find interesting. We have *The Consumer Finance Podcast*, which, as you might guess, is all things consumer finance related. *The Crypto Exchange*, devoted to trends, challenges, and legal issues in Bitcoin, blockchain, fintech, and RegTech. *FCRA Focus*, a podcast dedicated to all things credit reporting. And finally, *Payments Pros*, a great podcast focused exclusively on the payments industry. All of these insightful shows are available on your favorite podcast platform, so check them out.

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For today, as I mentioned, we're discussing potential changes to the larger participant role. And with us is our esteemed colleague, Chris Willis. Chris, welcome back to *Moving the Metal*.

Chris Willis:

Thank you so much for having me, and thank you for the Podfather title. That really made me crack up.

Brooke Conkle:

It's appropriate, right?

Chris Willis:

Well, thank you.

Chris Capurso:

Chris, we wanted to get it started, maybe not specifically talking about the larger participant rule, but talking about the body responsible for it, the CFPB, and obviously what's going on there. Could you give us a quick rundown of what has happened at CFPB?

Chris Willis:

Sure. I'll leave all the sort of personnel and budget stuff to the side because if I talk about that, it'll take too long. But in terms of regulatory activity, the CFPB has been busy evaluating and revisiting a lot of rulemakings that were finalized or in process under the previous administration or even before that. It's withdrawn a lot of pieces of informal guidance going all the way back to 2012, but many of which were released during the previous presidential administration. It's dismissed quite a few enforcement cases that were pending in court, although it has chosen to continue to litigate some of them. And as far as we can tell, we haven't seen much evidence of supervisory exams being continued or commenced by the bureau since the administration changed, nor enforcement investigations either coming back to life or being initiated since the administration change. I think the CFPB is busy revisiting and, in some instances, undoing the actions of its predecessor leaders, and that seems to be its primary focus at the moment.

Brooke Conkle:

Well, Chris C., why don't you tell us a little bit about the larger participant rule?

Chris Capurso:

Sure. I guess, as a basis, the larger participant rules for the CFPB, there are several of them, and they are specifically intended to define larger participants that will be subject to the supervision of the CFPB. In each of these rules, there's a sort of test to try to figure out what is a larger participant.

For the auto finance market, the test, and this will be a direct quote, is, "Unless exempt, a non-bank covered person that engages in automobile financing is a larger participant of the automobile financing market if the person has at least 10,000 aggregate annual originations."

That's the test. That is the basic test in the rule. And there were some definitions that are obviously going to be helpful to that because there's some words in there that are terms of art.

We've got aggregate annual originations, and that is the sum of the number of annual originations of the non-bank covered person and the number of annual originations of each of the non-bank covered person's affiliated companies. That's an important distinction. And that's calculated by putting together all of the following transactions for the preceding calendar year. That's going to be credit granted for the purpose of purchasing an automobile, automobile leases, refinancings, and any purchases or acquisitions of any of those obligations I just mentioned.

The term annual originations does not include investments in asset-backed securities and any purchases or acquisitions of obligations by a special purpose entity established for the purpose of facilitating asset-backed securities transactions. Obviously, that's quite a bit of credit. Basically, you've got RICs, you've got loans, you got refinancings, and you got leases. And you're going to put all that together to try to figure out your annual originations.

But, as I mentioned earlier, you're also going to combine whatever the company in focus and the affiliated companies. We are going to aggregate that together and try to come up with this number. And if that number exceeds the 10,000 of the test, then you are a larger participant, unless you're going to qualify for one of the exclusions. And the exclusions are specifically those excluded from the bureau's authority under 12 U.S. C 5519, which is the auto dealer exclusion. And those who would otherwise meet the definition of motor vehicle dealer, but would essentially be considered buy here, pay here dealers, those who are going to originate and hold the paper, not assign it to a third party. That is kind of the basic gist of the larger participant rule. It's not huge, but obviously has some significant implications.

Chris Willis:

Well, it was a very important rule when it came out because it subjected a whole lot of people to supervision. Brooke, what is the CFPB saying it wants to do with the rule now?

Brooke Conkle:

Chris, on August 8th, the bureau issued four advanced notices of proposed rulemaking inviting comments on potentially reducing the number of non-bank companies that could be subject to the bureau's supervision. And as Chris mentioned, that threshold is 10,000 aggregate annual originations. Easy to say. And the biggest slice of the non-banks covered by the larger participant role historically has been captives. Those auto finance companies owned by vehicle manufacturers.

But now the bureau says, "Maybe we've got too many participants in the market who are subject to the bureau's supervision." And instead, the CFPB has asked about raising that threshold from 10,000 to a higher number, perhaps we're talking maybe half a million, up to a million, 1.5 million. We're talking a lot of originations here.

And the bureau notes that even if the threshold is raised even to 550,000 aggregate annual originations, that's still going to cover two-thirds of the market. But as I mentioned, the bureau hasn't particularly suggested a number. It's just should we look at raising this threshold?

Chris Capurso:

So, my fellow Chris, I mentioned earlier the idea that there are several larger participant roles, and this is not the only revision that is being pondered among the larger participant roles, how does the one that we're talking about, specific to auto finance, compared to some of the other ones?

Chris Willis:

It's actually pretty similar, and all of them really follow a theme that was first evident in the so-called priorities memo that came out of the CFPB, I think it was in April of this year. If you go back and look at that priorities memo, the new leadership of the CFPB, the acting leadership of the CFPB essentially said, "We want to do less supervision in general. And in particular, we want to do less supervision of non-banks because non-banks are subject to supervision by state financial service regulators. They have to have licenses, and they get examined. And we think we should concentrate our resources on supervising only the largest banks."

Consistent with that, this group of larger participant advanced notices of proposed rulemaking that Brooke referred to in various different markets are all of the same theme to basically say we want there to be fewer larger participants subject to CFPB supervision than there are today. Contracting the universe from a larger number into a smaller number in various markets in which there are larger participant rules. And as I said, it's consistent with that April priorities memo where the CFPB basically is saying we want to do less supervision and specifically less non-bank supervision.

Brooke Conkle:

So, team Chris, is there anything about this rule that is essentially surprising? Chris, it sounds like this really is the CFPB doing exactly what it said it was going to do.

Chris Willis:

Honestly, the thing that surprises me is that they didn't propose to do away with the larger participant rules altogether. They're not mandated to have larger participant rules. That's at the agency's discretion. The bureau previously created all these, but the bureau could also say, "We don't want to do it anymore." And so, it's interesting that they decided to reserve supervision for a smaller number of participants in the market rather than just saying we're going to leave this to the states. So I'm a little bit surprised about that.

Brooke Conkle:

So if anything, this proposal really could be seen almost as a middle road. Yes, we're going to still supervise a certain number of non-banks that have a set number of aggregate annual originations, but still really reducing the number of companies that could be subject to the bureau's supervision.

Chris Willis:

Yeah. And from the standpoint of the bureau saying, "Hey, we want to be more efficient in our regulatory operations and concentrate our examinations where they will be impactful for more consumers," that makes sense. The idea being, "Well, we don't have to supervise a hundred, for example, auto finance companies. We could do 20 and still get most of the market. And so, we're using our smaller budget," which Congress has reduced its budget, "more wisely."

But the other thing to remember is that there's a corollary from the industry standpoint because now what it does is if the largest of the larger participants are still subject to supervision, but everybody else isn't, then that immediately creates sort of an imbalance in regulatory burden and pressure potentially between the largest participants and everybody else. And so it may give rise to feelings among the largest of the larger participants that they're being unfairly given a disadvantage as compared to their medium-size and small brethren. That's been a frequent criticism, for example, of large banks, that they have unfair competition from non-banks who aren't subject to scrutiny from as many regulators as them. And you can see a similar dichotomy among different-size auto finance companies.

Of course, all of that assumes that the CFPB actually does any supervisory exams of auto finance companies at all, which, presently, I'm not aware of any that are going on. Maybe the bureau intends to resume them at some point, but we have not seen evidence of that yet. And as long as they're not doing any, then this is academic only.

Brooke Conkle:

If the bureau revisits the larger participant rule, how is that going to impact the auto finance industry?

Chris Willis:

Well, again, if they're not doing that many examinations, period, it doesn't really make much of a difference. But assuming that they follow the larger participant rule and continue to do examinations of the largest participants, then it keeps the regulatory pressure up on them and relaxes it for essentially everybody else, at least for the time being. What we have to remember, though, is that these larger participant rules are not mandated or governed by statute. It is up to the agency's discretion as whether to have them and who to include in them.

And just as the original auto finance larger participant rule set the threshold where Chris talked about it being, and the new one may make it much larger, a subsequent administration can move it right back again. And so auto finance companies may feel like they're in a game of regulatory hokey pokey because they're in and then they're out and then they put themselves in again. Well, they don't put themselves in, but the CFPB puts them in again.

And so it's an important caution that anything like this that the CFPB does that's subject to its own discretion can just as easily go the other way in a future administration. And so it would suggest that those less than largest, large participants might need to guard against and prepare themselves for the return of CFPB supervision under a future presidential administration.

Chris Capurso:

Yeah. And to your point about why is it so targeted? I mean, it's like a scalpel. It's like in a very specific spot. I was very surprised when opening it up, and it was the number. I mean, they're just looking at the number. They're not looking at how you calculate the thing. I mean, if you're going to go through this whole process, like you said, it could just bounce right back in a couple of years because they're going through this process not to remove the rule, but to just change a threshold, a singular number inside the rule. To your point, it's just very interesting that they chose to do that to go through the rulemaking process, which we discussed on our last podcast, how important the rulemaking process is with the FTC CARS Rule. They're going to go through the actual process to do this to change that one number, rather than significantly change any aspects of this or do away with significant aspects of it. It's just an interesting choice. And to your point, maybe it means maybe the supervision is going to come in for the giant participants, I guess, is what we're going to have covered now. But then in a couple of years, maybe it's right back.

And with that, we'll wrap it up for today's podcast. Thank you to our audience for tuning in. Don't forget to check out our blogs, where you can subscribe to the entire blog or just the specific content you find most helpful. That's the ConsumerFinancialServicesLawMonitor.com and the TroutmanFinancialServices.com blogs. And while you're at it, why don't you head on over to Troutman.com, as Brooke mentioned, the new and improved troutman.com, and sign up for our Consumer Financial Services mailing list so that you can stay abreast of current issues with our insightful alerts and advisories and receive invitations to our industry insider webinars. And of course, please mark your calendars for this podcast, *Moving the Metal*, which we will be releasing every 2 weeks in 2025. That'll be generally on the second and fourth Tuesdays of each month. And as always, if you have any questions or if we can help in any way, please reach out to us. Until next time.