as student activists, including Joseph Rhodes (a Harvard junior fellow whose scholarship was devoted to the racism of imperial Britain). The commission heard testimony from people across the political spectrum in government and academia. The *Chronicle of Higher Education* thought it so important it reprinted the entire 419-page report.

Much has changed since Scranton was released. As one observer of the commission's proceedings, Suzanne Garment, recently reflected, "campus unrest of that time makes ours look like beanbag, with the contrast between grievances—from the Vietnam War to micro-aggressions—almost comic." Indeed, though today's protesters like to claim the mantle of the civil rights and antiwar movements of the 1960s, the truth is that college kids today have it pretty cushy: no danger of being drafted for them. And while they may believe that this country does not offer equal protection to racial minorities, the evidence on college campuses is pretty weak. There are no Halloween costumes or house parties that would make a campus in 2016 resemble the Jim Crow South.

Despite the seriousness of the problems back then—or perhaps because of it—the Scranton Report exudes a calm confidence, the sense that level-headed people from different sides of an issue can get together to investigate a problem and arrive at a solution. Of course, at that time people had a lot more faith in government commissions: Whether it was violence or the federal budget, there was nothing some smart guys in a room couldn't solve. After taking much testimony and talking it all over, the commission recommended offering more funding to black colleges and universities and more funding to increase, through recruitment, the presence of racial minorities at other institutions. They also suggested the appointment of administrators to negotiate between student radicals and college leaders.

But Scranton also reflected a long-gone consensus on what a university was for and who was in charge of it. "We call upon all members of the university to reaffirm that the proper functions of the university are teaching and learning, research and scholarship," the authors wrote. The commission members' understanding of academic freedom was also a relic of another time. "Academic institutions must be free . . . from outside interference, and free from internal intimidation," they wrote. "The pursuit of knowledge cannot continue without the free exchange of ideas." Universities, they urged, "must remain politically neutral." And the commission quaintly advised students: "Heckling speakers is not only bad manners but is inimical to all the values that a university stands for." When dealing with law enforcement, students were encouraged to avoid "the use of obscenities and derogatory terms such as 'pigs' and 'honkies.'"

The Scranton Report was an effort to deal with campus unrest while upholding the traditional ideals of the university and at the same time mollifying the insurgents. Since that time those two forces—the traditional ideals and the new politics—have been living in tension on the campus, with periodic eruptions when a conservative ventures onto campus to give a speech or when a naïve professor accidentally makes a statement at odds with the reigning race and gender orthodoxies.

The resolution of these disputes is always in favor of the protesters. Speakers are disinvited, faculty members reprimanded, dissenters denounced. And more recently it's college presidents who are being targeted. The result? No defenders of the traditional ideals are to be found at universities, and the insurgent groups can turn the campus upside down to demand more resources and respect any time they want.

In the end, the Scranton Commission recommended that President Nixon use his "moral leadership" to solve this problem. But Nixon refused. In his letter following the release of the report, the president said that responsibility for keeping the peace on campus "belongs strictly to the academic community." He was right—this was not a problem the federal government was ever going to solve—but the academic community failed miserably.

While campuses have not seen the kind of violence that they did in the '60s and '70s, they have remained in a state of turmoil for almost a half-century. It's clear who the winners are. ♦

The Rogue Regulator

The CFPB's unfair, deceptive, and abusive activities. BY RONALD L. RUBIN

The 2010 Dodd-Frank Act established the Consumer Financial Protection Bureau and authorized it to sue companies that commit "unfair, deceptive, or abusive acts or practices." Two staff reports and internal CFPB documents just released by congressional Republicans have exposed the new agency's attempt to circumvent the very law that created it through activities that epitomize these three types of violations.

A last-minute amendment to Dodd-Frank explicitly barred the CFPB from regulating or suing car dealers, who derive much of their revenue from lending. But Elizabeth Warren—whose advocacy for the consumer agency led to her becoming its first leader and then a United States senator—has never accepted this defeat. Nor have the lawyers she recruited to run the bureau, who launched a campaign to regulate car dealers shortly after the agency's birth.

Ronald L. Rubin was an enforcement attorney at the Consumer Financial Protection Bureau and chief adviser on regulatory policy at the House Financial Services Committee.

Dealers negotiate and execute most car loans in their showrooms and then, in essence, sell the loans to banks and other finance companies—businesses regulated by the bureau. These "indirect lenders" compensate dealers with profits approximately equal to the value of any additional interest borrowers are expected to pay because their loans carry interest rates higher than the lender's "buy rate" (the wholesale rate each lender calculates for a particular car sale). A risk-averse dealer won't finalize a loan without at least one finance company's guaranteed offer to acquire it at an acceptable buy rate.

The CFPB's not-so-secret wish is to eliminate dealers' incentive to negotiate higher interest rates with their customers—to "protect consumers" by preventing finance companies from paying dealers more than a small flat fee for each car loan. But lacking authority to regulate dealers, the bureau can only accomplish this by pressuring almost all indirect lenders to voluntarily adopt flat-fee compensation; otherwise, dealers will just assign their loans to financiers who pay what the loans are worth.

Upending firmly established industry practices and eliminating a major source of profit for car dealers has proven difficult, even for the powerful new agency. Faced with a steep uphill battle, the CFPB employed its most potent weapon—the race card. The bureau correctly calculated that financiers would go to great lengths to avoid the toxic publicity that accompanies even the most baseless discrimination lawsuit.

But the auto finance process has evolved dramatically since the last successful class action racial-discrimination lawsuits against indirect lenders. Such allegations are now, in fact, almost completely baseless. In the old days, dealers typically had relationships with a few indirect lenders with whom they often consulted while finalizing car loans. The Internet changed all that.

Beginning in 2001, Internet platforms such as DealerTrack and RouteOne allowed dealers to submit data to dozens of finance companies. These dealer management system (DMS) platforms operate a bit like online auction sites; dealers post legally permitted information—credit score, down payment, and car price, but not the buyer's race or age—and invite financiers to submit a buy rate and other offer terms for each loan.

The competition created by widespread use of the DMS platforms benefits consumers by lowering the wholesale price of capital available to dealers for loans. Dealers typically obtain a satisfactory guaranteed offer through a DMS platform before finalizing each car loan, and then return to the platforms to solicit better offers. This process has greatly reduced or eliminated preloan interaction between dealers and the finance companies that actually purchase any loan.

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Without meaningful preloan collaboration, indirect lenders cannot be said to "participate in the credit decision," the legal prerequisite for being a creditor that can be held liable for any dealer discrimination against borrowers. Therefore, CFPB enforcement actions against today's indirect lenders would be both legally dubious and tremendously unfair.

But fair treatment of financial service providers is not the mission of the CFPB, a consumer advocacy organization masquerading as a federal regulator. In March 2013, the bureau bypassed the administrative rulemaking process by issuing "guidance" that contained the thinly veiled threat of expensive discrimination lawsuits against finance companies that continued to "allow" dealers the "discretion" to negotiate retail interest rates with their own customers. The industry brushed off the guidance's advice to adopt fixed pricing; the CFPB sought to make good on its threat.

The problem for the bureau was that indirect auto lenders don't meet car buyers and have no information about their race, gender, age, or other protected classifications. In internal memoranda, CFPB lawyers admitted to having almost no evidence that finance companies discriminated or that lenders knew of any dealer discrimination. Therefore, to sue them the bureau had to invoke the "disparate impact" legal doctrine, which allows discrimination to be proven by statistics alone.

But the CFPB itself didn't know car buyers' race or ethnicity, because it is illegal for dealers to collect or keep such records. To overcome this obstacle, the bureau hired a pro-plaintiff consulting firm to create a proxy methodology—a probability model that guesses borrowers' races and ethnicities from their last names and addresses—with the scientific-sounding name "Bayesian Improved Surname Geocoding."

The CFPB was, and continues to be, deceptive about its proxy methodology's precision. In internal memoranda, agency lawyers described the model as "less accurate in identifying the race/ethnicity of particular individuals" than other available methods. To prevent independent analysis of the model, the CFPB refused, for almost two years, to reveal its mathematical formulas and testing data. Finally, under pressure from the Department of Justice, the CFPB released some, but not all, details of the methodology.

Not surprisingly, respected experts quickly labeled the methodology conceptually flawed and subject to significant bias and estimation error. Simple common sense dictates that race and ethnicity can't be determined with reasonable accuracy through addresses and surnames alone, especially for African Americans, whose last names are barely distinguishable from those of white consumers.

And race guessing was just the most obvious of many fatal flaws in the CFPB's statistical evidence. An equally disqualifying defect was that the only way to determine discrimination is to compare all of a particular dealer's loans. Analysis of indirect lenders' portfolios—which contain selections of loans made by dozens of dealers across the country—is virtually meaningless.

Furthermore, simple comparison of interest rates is insufficient because credit scores are key in determining loan interest rates, and average credit scores vary among racial groups. To get around this obstacle, the CFPB adopted the old class-action plaintiffs' strategy of comparing the average spread between the buy rates and interest rates of loans to whites and minority groups. However, this spread, which the bureau inaccurately calls "dealer markup," is affected by many race-neutral factors, including geography and used-versus-new car sales. The CFPB's most prominent statistics consultant told the bureau it should control for these race-neutral variables during disparate impact analysis. The bureau rejected his advice, which would have erased most of the already small racial disparities in its data.

The legal and statistical defects in the CFPB's allegations were so obvious that every indirect lender under investigation initially declined its settlement offers. Fortunately for the agency, it had a perfect target for an otherwise unwinnable lawsuit. Ally Financial Inc. had an application pending with the Federal Reserve to change its status from bank holding company to financial holding company. If the Fed did not approve the change by December 23, 2013, Ally would have to divest its large insurance and used-car remarketing operations.

In conferences with their Fed and Federal Deposit Insurance Corporation counterparts, CFPB attorneys confirmed that the FDIC could downgrade Ally's safety and soundness rating if the bureau accused Ally of discrimination, and that the Fed would deny Ally's application based on such an FDIC downgrade. It just so happened that the director of the CFPB, Richard Cordray, was also a member of the FDIC's five-man board of directors.

Thus, Cordray could first approve his CFPB lawyers' allegations that Ally had discriminated. Then, as an FDIC director, he could use those allegations to justify voting for a reduction in Ally's safety and soundness rating, thereby guaranteeing Fed denial of the company's application. In other words, Cordray could almost singlehandedly block Ally from obtaining financial holding company status, which would compel his potential litigation adversary to divest two of its most important businesses.

Despite the CFPB's powerful leverage, Ally refused to adopt flat-fee compensation, informing the bureau that "to do so would be 'corporate suicide'" because dealers would simply offer their loans to its competitors. As punishment, the bureau's lawyers forced Ally to pay the maximum they believed the company could afford, $98 million.

PETE MAROVICH / BLOOMBERG / GETTY

Elizabeth Warren

In congressional testimony last September, Cordray unapologetically admitted he had used Ally's pending Fed application to force the company to settle with the CFPB, saying, "I didn't create the leverage. I didn't set that up."

But Cordray and his lawyers did create their leverage. They targeted Ally specifically because of its pending Fed application, manufactured seriously flawed statistical evidence of discrimination, concocted a dubious legal theory, and threatened litigation the bureau could not win fairly. They contrived a bogus lawsuit with a built-in regulatory roadblock to ensure its success.

The Dodd-Frank Act defines an abusive act or practice as one that "takes unreasonable advantage of . . . the inability of the consumer to protect [his or her] interests." The CFPB clearly took unreasonable advantage of Ally's regulatory vulnerability, the paradigm of an abusive act. A less euphemistic description of the bureau's behavior would be extortion.

The huge settlement scared a few other lenders into resolving similar accusations for much smaller sums, but it created an unusual problem. The bureau claimed that Ally had caused $80 million of harm to 235,000 minority consumers, but in truth this made-up figure represented Ally's cost of avoiding rejection by the Fed. Now, to sustain its fiction, the CFPB had to pay out this restitution. Finding actual minority borrowers who could have suffered $80 million in discrimination harm was quite a challenge.

And so a year and a half after the settlement, none of the alleged victims had been contacted. Finally, over objections from the Department of Justice, the CFPB sent letters to 201,212 borrowers that the bureau's race-guessing model labeled as having a higher probability of being minorities. They were informed of the settlement and told in bold letters, "To receive your payment, you do not need to do anything."

The CFPB sent out an additional 218,457 letters to borrowers for whom the model assigned lower probabilities of being minorities, telling them they could receive a check just by returning a simple form claiming to be a member of a protected race—without even specifying which race. These forms didn't require sworn affirmations or even include warnings against fraud. The CFPB's plan was to verify Ally's alleged consumer harm by knowingly paying millions of dollars in discrimination restitution to white car buyers.

The revelations of the CFPB's unfair, deceptive, and abusive activities have created such outrage that a bill to stop the bureau's assault on auto lenders easily passed in the House, with significant Democratic support. In the Senate the legislation may survive Elizabeth Warren's fervent opposition. The episode could even result in the CFPB being restructured as a bipartisan commission, exposing the regulator's operations to some much-needed sunlight. ♦

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