

Credit on Wheels

Jim Hawkins*

As traditional sources of credit have become scarcer, more and more Americans are turning to alternative financial service providers when they need or want money.¹ Some of these fringe banking firms take personal property as collateral for high-interest loans, while others tie small dollar loan amounts to the borrower's next paycheck. Another common fringe banking transaction, the auto-title loan, is a source of credit for millions of Americans, but it has not generated the same scholarly interest as pawn and payday loans.

In an auto-title loan, a borrower typically takes out a one month loan at a high interest rate and gives a security interest to the lender in a vehicle that has no other liens on it.² If the borrower defaults on the loan, the lender has the right to repossess and sell the collateral. It is not surprising that this transaction creates concern among policymakers because it involves people who are outside of the mainstream banking system risking potentially their most valuable asset and their only means of transportation.

Despite the important concerns title lending raises, little empirical work has been done to understand the central questions policymakers need answered in order to craft optimal title lending laws.³ Additionally, states regulate title loans through many diverse approaches, but there are few legal analyses of the different mechanisms states use to govern title loans.

This Article hopes to contribute to the research on title loans by tackling these two issues. First, in Part I, I offer new empirical evidence about the title lending transaction, paying special attention to the risks borrowers face when they use their vehicles as collateral for the loan. I gathered this evidence by obtaining new reports from state regulators about the title lending industry, examining public disclosure statements by title lenders, interviewing title lenders, and surveying a small group of title lending customers.

Second, I organize the different legal responses to title lending in Part II, creating a taxonomy of regulatory approaches. States govern title loans by banning them, permitting them

* Assistant Professor of Law, University of Houston Law Center. For excellent research assistance, I thank Adam Nalley, Matthew Ezell, Drew Knowles, Joseph Guajardo, and Rebekah Smith.

¹ FEDERAL DEPOSIT INSURANCE CORPORATION, FDIC NATIONAL SURVEY OF UNBANKED AND UNDERBANKED HOUSEHOLDS 10 (2009) (finding that 25.6% of US households are unbanked or underbanked).

² See *infra* Part I.B.

³ Only two law review articles extensively take up the question of title lending. Todd Zywicki, *Consumer Use and Government Regulation of Title Pledge Lending*, 22 LOY. CONS. L. REV. 425 (2010); Nathalie Martin & Ozymandias Adams, *Grand Theft Auto Loans: Repossession and Demographic Realities in Title Lending*, 75 MISSOURI LAW REVIEW (forthcoming 2011).

to operate despite of usury limits through legal carve outs, such as pawnshop laws, and explicitly authorizing them and regulating them through statutes geared directly at title lenders.

In light of the business realities of title lending and the current regulatory strategies, Part III argues that the best approach to regulating title lending is for states to adopt laws specifically aimed at authorizing and regulating title loans. I offer several tentative suggestions for laws that are particularly important to protect consumers using title loans. For example, I urge states to adopt laws that require lenders return surpluses from sales of collateral but that restrict lenders from pursuing deficiencies. Also, I suggest laws that require plain disclosures of the cost of title loans and the risks of repossession and costly rollovers. In contrast, I find that laws aimed at setting limits on the amount a lender can loan or capping the amount a lender can charge as an interest rate likely harm the customers who are most vulnerable to injury from title lending. The main policy goal underlying many of my suggestions is to encourage lenders to offer higher loan amounts in exchange for the collateral pledged, thus protecting those borrowers who lose vehicles through repossession and risk losing the equity they have accumulated in their cars. The suggestions are tentative because many of the important empirical questions about title lending still require research.

I. THE TITLE LENDING BUSINESS

Many of the questions at the heart of the debate over title lending policy are empirical. This Part introduces new data about these pivotal issues. Specifically, after discussing my research approach, I introduce new evidence about the transaction itself and the use of vehicles as collateral.

A. Research Approach

To gather new information on the title lending industry, I first collected and compiled data from state regulators who obtain information from title lenders pursuant to licensing laws. Some of these state reports are publicly available. The reports from Tennessee have been discussed in the past, but I also discovered public reports from Virginia and Oregon, which have been overlooked in prior research. In addition to these publicly available reports, I obtained reports from Illinois through a request under the Illinois Freedom of Information Act and from Montana and Idaho through informal requests to the individuals responsible for generating those states' reports.⁴

Second, I reviewed public disclosure filings by title lenders. There are few public companies doing title lending, but in addition to one public firm's annual report, I reviewed the

⁴ New Mexico also produces a report about title lending, but Martin and Adams present this data in extensive detail, so I do not discuss it here other than to highlight my different interpretations of those reports. *See generally* Martin & Adams, *supra* note xx.

bankruptcy filings and security re-characterization filings of TitleMax, one the nation's largest lenders.

Third, I interviewed title lenders. I spoke with lenders from a variety of types of businesses—large lenders who only do title loans, large multi-line lenders, and small lenders. These interviews were conducted in person or over the phone.

Finally, I attempted to survey title loan customers. I designed a survey instrument, reproduced in Appendix A, and trained two research assistants how to administer the survey. These two research assistants spent more than 50 hours waiting together for customers to enter stores at title lending locations throughout Houston, Texas. The research assistants varied the times and days of the week that they were at stores.

When customers exited the title lending store, the research assistants approached them, explained the survey, and offered a \$10 Target gift card as a thank you for completing the survey. Everyone approached was given an informed consent handout, and the study was approved by the University of Houston's Committee for the Protection of Human Subjects. The response rate was 64.82%, but overall only 35 people completed the survey.

Several things prevented a larger number of customers from participating in the survey. Importantly, most stores did not have many customers come each day. Some stores had only one or two people over a three hour time period. Others had no customers during a three hour period. Additionally, it was difficult to determine when the stores would be busy because, unlike payday loans that are tied to a pay period,⁵ title loans can be originated any day of the month. We had the most success at a single store, Lonestar Title Loans, simply because it was a much busier store than any other location. 85.71% of the completed surveys came from this location, while the others came from a variety of other stores across Houston.

The survey results are obviously not representative of title lending customers generally, title lending customers in Texas, or even those in Houston. And, even if the results were representative, the sample size is problematically small. Thus, I present the information I obtained from the surveys here merely as anecdotal evidence about title lending customers, and I hope lessons learned from this survey attempt can inform future customer-based research about title lending. My only claim about the survey is that it represents the actual people we surveyed.

B. The Title Loan Transaction

Some of the important policy questions surrounding title lending relate to the transaction itself. In the traditional version of the product, title loans are one-month long loans. The entire

⁵ Nathalie Martin surveyed payday lending customers using the same approach with more success by waiting outside stores on Fridays. She obtained results from 109 people. Nathalie Martin, *1,000% Interest - Good While Supplies Last: A Study of Payday Loan Practices and Solutions*, 52 ARIZ. L. REV. 563, 597 (2010).

balance—principal and interest—is all due at the end of the month. If the borrower cannot pay the principal, the lender will allow an interest-only payment to rollover the loan another month.⁶

To obtain the loan, the lender usually requires the borrower to bring a clear title to the vehicle, the actual vehicle, identification, names of references, and sometimes proof of income.⁷ In a process that takes twenty to forty minutes,⁸ the lender evaluates the value of the vehicle, often through the use of commercial guides or proprietary software.

1. Why do people take out title loans?

The reasons people use title loans have enormous policy implications. If a significant percentage of title loans fuel small business growth, banning the transaction could hamper job creation in the midst of a recession. Also, if title loans allow lower income Americans to overcome emergency situations like unexpected medical expenses or car repairs, they serve an important social function. However, a trenchant argument against title lending has been that it just delays inevitable financial breakdowns because people use the loan to pay for normal expenses. As it turns out, there is evidence of each of these uses: business expenses, emergency expenses, and normal expenses.

A couple of studies have documented the reasons people take out title loans. An FDIC survey of unbanked and underbanked households asked individuals about why they used fringe credit products, including pawn loans, payday loans, and rent-to-own. Although it did not ask about title loans, the results are still relevant because the customer base is similar. The FDIC found that 38% of people used credit from alternative financial service providers for basic living expenses, 15.4% used it to make up for lost income, 7.4% used it for house repairs or purchasing an appliance, 6.2% used it for special gift or luxuries, 4.5% used it for car repairs, 2.3% used it for medical expenses, and 26.3% used it for other reasons.⁹

I did uncover one survey specifically aimed at title lending customers. One large title lender conducted a survey and provided it to me, although the lender asked to remain anonymous. In 2007, the lender's customers in New Hampshire, New Mexico, Kansas, Virginia, and Oregon completed surveys in conjunction with taking out loans. The lender gave participants a \$20 loan coupon in exchange for completing the survey. The lender compiled the

⁶ Michael S. Barr, *Banking the Poor*, 21 YALE J. ON REG. 121, 164-65 (2004); Lynn Drysdale & Kathleen E. Keest, *The Two-Tiered Consumer Financial Services Marketplace: The Fringe Banking System and its Challenge to Current Thinking About the Role of Usury Laws in Today's Society*, 51 S.C. L. REV. 589, 598-600 (2000).

⁷ As one example of these requirements, see Advantage Financial, LLC, Application For Title Loan In Houston, TX, at <http://www.cartitleloanshouston.com/pages/application.html> (last visited Aug. 21, 2011).

⁸ TMX Finance LLC, Form S-4 (Dec. 31, 2010) at 41.

⁹ FEDERAL DEPOSIT INSURANCE CORPORATION, *supra* note xx, at 42.

data by state into a report.¹⁰ In analyzing the report, I aggregated the data from the five states. Table 1 summarizes the results when the lender asked what the “[n]eed for loan was caused by.”

Table 1: Title Lender Survey on Reasons Customers Took Out Loan

Reason	Percentage of Borrowers¹¹	Number
Car maintenance/ repair	29.18%	314
Unusually high utility bill	19.33%	208
Help with mortgage/ rent	28.90%	311
Unexpected medical emergency	14.87%	160
Delay in payment of expected income/missed paycheck	29.55	318
Other	8.74%	94

These lists of reasons have both emergency expenses (roughly 14.2% - 29.6% in the FDIC’s survey¹² and 92.93% in the lender’s survey¹³) and regular expenses (roughly 38% in the FDIC’s survey¹⁴ and 28.09% in the lender’s survey¹⁵). Thus, the policy question is more difficult than just labeling the use of title loans as either purely emergency or routine spending. It appears to involve both.

¹⁰ The report is on file with the author. I obviously am taking the data at face value. I was not involved in designing or administering the survey, so I do not have information about its research design, about how it was conducted, or about the response rate beyond the details I have presented here.

¹¹ To calculate the percentage of borrowers citing a reason, I added up all of the responses to another question about the borrower’s occupation and divided the reason for the loan by that number. The number of responses to the question about what need led to the loan was 1405, but the total number of people providing an occupation was 1076. Thus, it appears that some people listed multiple reasons for needing the loan, which explains why my percentages add up to more than 100%.

¹² These numbers represent those stating the reason for the loan was for house repairs, car repairs, and medical expenses (equaling 14.2%) plus those stating the reason was lost income (15.4%), depending on whether one considers this to be an emergency expense or not.

¹³ This number represents those stating the reason for the loan was Car maintenance/ repair, Unusually high utility bill, Unexpected medical emergency, Delay in payment of expected income/missed paycheck.

¹⁴ This number represents those stating the reason for the loan was basic living expenses.

¹⁵ This number represents those stating the reason for the loan was for help with mortgage/rent.

A similar ambiguity exists about whether a significant portion of loans are for business reasons. Todd Zywicki reports from his interviews with industry members that title loans help small business owners who do not have ready access to traditional sources of credit and who plan to repay the debt quickly.¹⁶ Zywicki estimates that 25 to 30% of title lending customers fit into this category.¹⁷ People within the industry confirm that many title loan customers are small business owners¹⁸ and use their vehicles as a source of capital to operate their businesses.¹⁹ TitleMax's securities filing states that customers are often "self-employed small business owners with an immediate need for short-term working capital."²⁰ Even a member of Congress has claimed that title loans can help save small businesses from failing.²¹

In the survey the title lender provided to me of its customers, 19.70% (n=212) of customers identified themselves as self-employed. The lender, however, did not ask customers whether the loan was for business-related or personal needs, so it is not clear whether these self-employed customers were using the loan for business purposes. In listing the need that prompted the loan, very few customers listed expenses that appear like business expenses. Four responses in the "other reasons" category were explicitly business-related—"starting a new business," "Down payment for new work truck," "new business," and "Purchase of Semi." Additionally, other categories could have included business-related reasons, such as car maintenance/repair, unusually high utility bill, help with mortgage/rent, and delay in payment of expected income/missed paycheck.

In my survey, I asked borrowers whether they were taking out the title loan for business expenses, personal expenses, or a combination of the two and I clarified that personal expenses

¹⁶ Zywicki, *supra* note xx, at 449.

¹⁷ *Id.*

¹⁸ Interview with Anonymous Director of Government Affairs for Large Title Lending Company (Dec. 14, 2010) [*hereinafter* Anonymous Interview] (on file with author) (noting that the company only makes consumer loans but that "a significant percentage of our customer base owns their own business"); Tommy Davis & Justin Davis, President & Vice-President, TJD Financial Services, Inc. (Aug. 24, 2011) [*hereinafter* Davis & Davis Interview] (on file with author) (estimating that 10% of their loans are for business purposes).

¹⁹ Dena Potter, *Va. Car Title Lending Law Takes Effect Friday*, BLOOMBERG BUSINESSWEEK, Sept. 29, 2010, available at <http://www.businessweek.com/ap/financialnews/D9IHLNUO1.htm> ("Scott Johnson, a lobbyist for title lender Community Loans of America, said . . . many borrowers are small business owners who rely on their vehicle for capitol in order to run their businesses.")

²⁰ TMX Finance LLC, Form S-4 (Dec. 31, 2010), at 40.

²¹ 146 CONG. REC. H5179-02 (daily ed. June 27, 2000) (statement of Representative McCollum) ("I praise the Floridian approach of title lending because it weighs both the importance of curbing the abuses that too often surround title loan transactions against the importance of providing otherwise 'un-lendable' borrowers with access to credit. This emergency credit can keep a small businessman from going under, or cover immediate needs at the end of the month.").

included buying gas to get to work. Among those we surveyed 25.71% (n=9) said they were using the loan at least in part for running their own business.

2. *How much money do stores lend to customers?*

How much money stores lend to borrowers plays an important role in several of the policy issues surrounding title lending, such as the arguments that title lending causes financial distress because people take on excessive debt loads and that title lenders strip equity from borrowers by lending them only a small percentage of the value of their vehicle. We can measure how much title lenders give to customers in a variety of ways—the amount lent in absolute dollars, the amount lent relative to the value of the vehicle, or the amount lent relative to the borrower’s income. This section evaluates the data for each of these three measurements.

a. Absolute dollar amounts.

There are several data points about how much, in absolute dollars, title loan companies lend to customers. An earlier academic study reports the average advance is \$275.²² EZCORP, a public company that does title lending, states in its annual report that \$700 is its average loan amount²³; TitleMax swears in a securities filing that “[o]ur customers borrow on average approximately \$1,100 and \$850 at our TitleMax and TitleBucks stores, respectively”²⁴; and one smaller Texas-based firm reported its average loan was for \$1,000.²⁵ State regulators report averages of \$793.80 in Illinois,²⁶ \$562 in Montana,²⁷ \$847 in Virginia,²⁸ and \$243 in Oregon.²⁹ The modal amount of a title loan (representing 40% of agreements) in Tennessee was \$251-\$500.³⁰

²² JOHN P. CASKEY, LOWER INCOME AMERICANS, HIGHER COST FINANCIAL SERVICES 46 (1997).

²³ EZCORP, Inc., Annual Report (Form 10-K), at 6 (Sept. 30, 2009).

²⁴ TMX Finance LLC, Form S-4 (Dec. 31, 2010), at 41.

²⁵ Davis & Davis Interview, *supra* note xx.

²⁶ STATE OF ILLINOIS, PAYDAY LOAN CONSUMER REPORTING SERVICE, TITLE LOAN AGGREGATE DATA OCTOBER 2009 THROUGH JUNE 2011 (on file with author) [*hereinafter* Illinois Report].

²⁷ STATE OF MONTANA, COMPOSITE REPORT OF OPERATIONS OF MONTANA TITLE LOAN LICENSEES: CALENDAR YEAR 2009 (on file with author) [*hereinafter* Montana Report].

²⁸ BUREAU OF FIN. INST., STATE CORP. COMM., COMMONWEALTH OF VA., THE 2010 ANNUAL REPORT OF THE PAYDAY LENDER LICENSEES, CHECK CASHERS, MOTOR VEHICLE TITLE LENDER LICENSEES at 84 (Dec.31, 2010), available at <http://www.scc.virginia.gov/bfi/annual/ar04-10.pdf> [*hereinafter* Virginia Report].

²⁹ STATE OF OREGON, OREGON LICENSED CONSUMER FINANCE COMPANIES (2009), available at http://www.cbs.state.or.us/external/dfcs/cf/annual_reports/2009.pdf [*hereinafter* 2009 Oregon Report].

³⁰ TENNESSEE DEPARTMENT OF FINANCIAL INSTITUTIONS, THE 2010 REPORT ON THE TITLE PLEDGE INDUSTRY (Mar. 2010) at 6, available at <http://www.tennessee.gov/tdfi/compliance/tpl/TPLReport2009Final.pdf> [*hereinafter* 2010 Tenn. Report].

Each of these data points reflects the laws in the jurisdictions reporting them. Oregon, for instance, limits lenders to charging 36% APR interest rate but allows them to charge a one-time fee of \$30, which appears to cause lenders to lend close to \$300.³¹ Tennessee caps loans at \$2,500,³² resulting in lower averages. I do not have data from California, but we would expect much higher loan averages there because lenders lend more than \$2,500 to avoid usury limits.³³ Thus, not only is a national average impossible, it is meaningless without the context of the state's laws.

While we may not be able to fix an exact amount as the standard title loan, the data do suggest title loans are generally for small amounts. Martin and Adams have argued that title “loans are by no means small.”³⁴ As evidence, they point out that “[o]ne internet company offers loans of up to \$50,000, and the New Mexico state data reflect loans up to \$42,000.”³⁵ These single examples, however, are poor evidence that title loans are generally not small because they are not representative. Aggregate data from Montana, for instance, indicates that only 0.42% of loans in 2009 were for more than \$4,000,³⁶ while 97.41% of loans were for less than \$2,000.³⁷ In Tennessee in 2009, “only 3% were made for amounts between \$2,251 and \$2,500 which is the maximum loan amount permitted by law.”³⁸ Thus, while it is difficult to make generalizations, it appears generally title loans are for low amounts.

b. Money lent relative to the value of the vehicle.

In addition to measuring the absolute amount of title loans, we can also measure the amount lent in relation to the value of the vehicle. Again, different sources claim different percentages of the vehicle's value are lent, ranging from “about 25% of the wholesale value of the car”³⁹ to 80% of the value of the vehicle.⁴⁰

³¹ OR. REV. STAT. § 725.622(1) (2007), repealed by Or. Laws Spec. Sess., ch. 23, § 34 (2010) (maintaining the 36 percent interest rate and allowing a one-time fee for a new loan).

³² TENN. CODE ANN. § 45-15-115(3).

³³ CAL FIN CODE § 22303.

³⁴ Martin & Adams, *supra* note xx, at 6.

³⁵ *Id.*

³⁶ 53 loans out of 12727. Montana Report, *supra* note xx.

³⁷ 12397 loans out of 12727. *Id.*

³⁸ 2010 Tenn. Report at 6

³⁹ CASKEY, Lower Income, *supra* note xx, at 44.

⁴⁰ Leslie Parrish, Senior Researcher, Center for Responsible Lending, Webinar: Baby, You Can Take My Car: The Dangers of Auto Title Loans (July 15, 2010), at <http://www.nclc.org/conferences-training/auto.html> (click on

Lenders I interviewed similarly gave me a range of percentages for how much they will lend: one said it typically lends 50% of the wholesale value of the car⁴¹; another said it lends one-third to 80% of the Black Book⁴² value of the vehicle depending on the year and condition of the car⁴³; and another reports it lends 40% to 70% of the Kelly Bluebook wholesale value of vehicles.⁴⁴ Industry giant TitleMax went through a Chapter 11 bankruptcy recently, and in its disclosure statement sent to creditors who would vote for its Chapter 11 plan, it stated that “[u]sing the appraised value of the Vehicle, and based upon the customer’s need, the Debtors will lend up to 80% of the appraised value of a Vehicle.”⁴⁵ TitleMax’s recent Form S-4 goes into greater detail:

Store managers appraise the wholesale value of the customer’s vehicle based on the following characteristics of the vehicle: year, make, model, exterior, interior and mechanical condition and mileage. One factor our managers consider in determining asset value is the most conservative wholesale value of the customer’s automobile listed in the Black Book, as opposed to the higher retail value listed in the Black Book (for the year ended December 31, 2010, the “rough” wholesale value amount was on average 64% less than the retail value amount). This reduces the overall risk of our title loans receivable by having more conservative loan to value ratios (at origination, our receivables had an approximately 69% weighted average loan to appraised wholesale value and an approximately 25% weighted average loan to Black Book retail value), which results in more security for each loan and less overall risk for our company.⁴⁶

Two puzzles emerge when we consider the relationship between the vehicle’s value and the loan’s amount. First, it is difficult to assess whether lenders are giving loans that are “too high” or are “too low.” On the one hand, people who want to ensure borrowers can repay the loans complain the loan amounts are too high.⁴⁷ On the other hand, those worried that borrowers lose equity when title lenders repossess consumers’ vehicles and do not return the surpluses

“Recording” under Baby, You Can Take My Car: The Dangers of Auto Title Loans) [*hereinafter* Parrish webinar] (noting she has seen 80% of value of car loaned to title customers).

⁴¹ Anonymous Interview, *supra* note xx

⁴² The Black Book is a regularly published guide that provides the value that cars sold at auctions. Black Book, Overview, <http://www.blackbookusa.com/home.aspx?m=2&s=1&t=D&i=20> (last visited Aug. 9, 2011).

⁴³ Interview with Robert Reich, President, Community Loans of America (Jan. 18, 2011) [*hereinafter* Reich Interview] (on file with author).

⁴⁴ Interview with Alex Vaugh, Vice President of Government Relations & Shawn Bourns, Director in Operations Development of Retail Services, Cash America, Inc. (Nov. 22, 2010) [*hereinafter* Vaugh & Bourns Interview] (on file with author).

⁴⁵ Titlemax Disclosure Statement, *supra* note xx, at.

⁴⁶ TMX Finance LLC, Form S-4 (Dec. 31, 2010), at 42. *See also id.* at 22 (“At origination, our weighted average loan amount is approximately 69% of appraised wholesale value and approximately 25% of the Black Book retail value.”).

⁴⁷ *See infra* Part II.A.1.c.

argue that lenders do not lend sufficiently high percentages of the vehicle's value.⁴⁸ Moreover, research indicates that higher loan amounts may actually decrease the likelihood of default.⁴⁹

The second puzzle that emerges from considering the amount of the loan in relation to the vehicle is whether title loans are oversecured or undersecured. The common wisdom is that title loans are oversecured or at least fully secured, so lenders are taking essentially no risk in lending money.⁵⁰ More pointedly, members of Congress and others claim that lenders benefit when they repossess and sell vehicles because the lenders retains the surplus from the transaction.⁵¹ Yet, another common charge against title lenders is that lenders seek deficiencies from borrowers. Martin and Adams argue that title loans are recourse loans and that lenders do sometimes seek deficiencies from borrowers.⁵²

So which are they—oversecured or undersecured? The data on the issue is as muddled as the claims made by opponents of title lending, seeming to support both sides. Data from state regulators suggest that either most loans are not oversecured, at least in the technical sense of

⁴⁸ 146 CONG. REC. H5179-02 (daily ed. June 27, 2000) (statement of Representative Mascara).

⁴⁹ Will Dobbie & Paige Marta Skiba, Information Asymmetries in Consumer Credit Markets: Evidence from Payday Loans at 2 (July 10, 2011), Vanderbilt Law and Economics Research Paper No. 11-05, at <http://ssrn.com/abstract=1883230> (“We estimate that for a given borrower, a \$100 increase in loan size decreases the probability of default by 3.7 to 4.2 percentage points. This is a 20 to 23 percent decrease from the mean default rate. While not ruled out by theory, our finding of advantageous incentive is perhaps surprising given the emphasis on adverse incentives (e.g. moral hazard) by both policymakers and the theoretical literature.”); Colleen Creamer, *Payday Loans: Taking the Good with the Bad*, NASHVILLE LEDGER, Aug. 19, 2011 (“‘I think that raising the limit actually may be a good thing for borrowers,’ Skiba says. ‘I’ve done research on this, and it shows that, when people are allowed to borrow larger amounts, it actually helps them to repay the loan rather than renewing it a bunch of times and then eventually defaulting.’”).

⁵⁰ Annesley H. DeGaris, *Car Title Lending*, 2 AMERICAN ASSOCIATION FOR JUSTICE: AAJ ANNUAL CONVENTION REFERENCE MATERIALS (July 2007) (arguing that high rates “cannot be justified by the amount of risk assumed by the lender or business-related expenses, as the loans are fully secured and the lender does not store the pledged item while the debt is outstanding”); Martin & Adams, *supra* note xx, at 1 (“A title loan is a high-interest, deeply oversecured, consumer loan”); Kristin Arnold, *Car Title Lending: Short-term Fix with Long-Term Expense*, BankRate.com, Nov. 18, 2005, <http://www.bankrate.com/finance/auto/car-title-lending-short-term-fix-with-long-term-expense-1.aspx> (“The loan-to-value ratio is rarely greater than 33 percent, making it a win-win situation for the lender if the borrower defaults.”).

⁵¹ 146 CONG. REC. S167-05 (daily ed. Feb. 1, 2000) (statement of Senator Wellstone) (“Someone can take out a \$100 loan, and the car might be worth \$2,000, and these companies that we don't do a darn thing about You repossess their car. You sell the car. You don't even give them back the additional money you make beyond what they owed you.”); 146 CONG. REC. H5179-02 (daily ed. June 27, 2000) (statement of Representative Mascara) (“When these loans are structured as a title pawn transaction, the title pawn broker sells the automobile and retains transfer to the pawn broker. The consumer loses all of his or her equity in the automobile and typically has little or no recourse to regain the automobile.”); DeGaris, *supra* note xx (“Because . . . [they] are usually over-secured, these lenders face no risk from default. In fact, consumer advocates argue that title lenders *benefit* when a debtor defaults, thus allowing the lender to confiscate and resell the vehicle.”)

⁵² Martin & Adams, *supra* note xx, at 32.

that word, or that title lenders are violating the Uniform Commercial Code on a massive scale. In Tennessee in 2008, for instance, title lenders returned only \$251,047 to borrowers as surpluses, but they wrote off \$13.6 million in unrecoverable principal.⁵³ While it is possible the unrecovered principal is partially derived from situations where something prevented the lender from recovering the vehicle at all such as theft or the destruction of the vehicle, the fact that unrecovered principal was roughly 52 times the amount of surpluses suggests that the loans generally were undersecured.

The notion that lenders repossess vehicles to generate significant profits is almost certainly wrong. Repossessing, storing, and selling vehicles are expensive relative to the value of most pledged vehicles. One operator estimated the costs at around \$500 for his company-- \$250 to pay a company to repossess the vehicle and \$250 to pay for the sale⁵⁴; another confirmed that “[r]epossession, at best, are a breakeven process and most often simply mitigate our loss.”⁵⁵ Tennessee’s report from 2007 found firms spent \$92.10 for repossession, \$72.05 for storing vehicles until sale, and \$4.02 for advertisements.⁵⁶ These costs do not include collection costs and legal fees which lenders are probably entitled to under the title lending contracts. If we assume these sales generate half the vehicles’ value for the lender, the lender only makes money on cars that are on the higher end of the spectrum. As one lender pointed out to me, the proceeds from interest and fees are much more profitable than the proceeds from repossession, so lenders have little incentive to repossess cars to generate revenue.⁵⁷

Thus, it appears that most loans are not, under the technical definition of the word, oversecured. But, on the other hand, lenders rarely seek deficiencies from customers. In Oregon, .06% of loans in 2005⁵⁸ and .20% of loans in 2006⁵⁹ resulted in lenders obtaining a money judgment against a borrower. Lenders⁶⁰ and even consumer advocates⁶¹ maintain that lenders generally do not pursue deficiencies even when it is legal to do so.

⁵³ 2010 Tenn. Report at 8. Other years in Tennessee are similar. In 2006, lenders returned \$1,256,068 to consumers but had \$11,394,220 in unrecovered principal. In 2007, lenders returned \$171,579 to customers but had \$5.1 million in unrecovered principal. 2007 Tenn. Report at 7.

⁵⁴ Reich Interview, *supra* note xx.

⁵⁵ Anonymous Interview, *supra* note xx.

⁵⁶ 2007 Tenn. Report at 7.

⁵⁷ Davis & Davis, *supra* note xx.

⁵⁸ 12 of 17801 loans resulted in the lender obtaining a money judgment.
http://www.cbs.state.or.us/external/dfcs/cf/annual_reports/2005.pdf

⁵⁹ 31 of 15726 loans resulted in the lender obtaining a money judgment.
http://www.cbs.state.or.us/external/dfcs/cf/annual_reports/2006.pdf

⁶⁰ For instance, although Texas law permits it to seek deficiencies, TDJ Financial Services never has in its 11 years operating in the state. Davis & Davis Interview, *supra* note xx. AARAL also claims its members will not seek

Based on this data, a disturbing asymmetry of title lending emerges. Even though from the lenders' perspective lenders do not have much to gain from repossessing a car (because the loans are not technically oversecured), borrowers have a lot to lose because the equity they hold in their vehicle is consumed by the costs of repossession and resale.⁶² Regulation needs to account for this lack of symmetry.

More importantly, the customers at the greatest risk are those who are probably in the weakest economic position—people with less valuable vehicles as collateral. If a customer's car is only worth \$400, but the customer gets a loan for \$200 and defaults, the transaction will almost certainly generate a deficiency because the customer's small amount of equity will be quickly used up by repossession costs. The less expensive the car, the more likely the lender will be unable to recoup the principal from repossession alone.

c. Money lent relative to income.

Opponents of title lending repeatedly argue that one of the chief predatory features of title lending is that lenders do not consider customers' abilities to repay the loans.⁶³ This argument has had traction with policymakers,⁶⁴ and title loan customers have sued because title lenders do not consider ability to repay.⁶⁵

deficiencies. AARAL, AARAL Best Practices Safeguard Consumers, at <http://www.responsibleautolenders.org/bestpractices/> (last visited Aug. 26, 2011).

⁶¹ Jay Speer, Executive Director, Virginia Poverty Law Center, Webinar: Baby, You Can Take My Car: The Dangers of Auto Title Loans (July 15, 2010), at <http://www.nclc.org/conferences-training/auto.html> (click on "Recording" under Baby, You Can Take My Car: The Dangers of Auto Title Loans); Sarah Mattson, Policy Director/NH Health Law Collaborative Director, New Hampshire Legal Assistance, Webinar: Baby, You Can Take My Car: The Dangers of Auto Title Loans (July 15, 2010), at <http://www.nclc.org/conferences-training/auto.html> (click on "Recording" under Baby, You Can Take My Car: The Dangers of Auto Title Loans).

⁶² Ronald Mann describes this asymmetry as a common feature in collateralized loans. See Ronald J. Mann, *Verification Institutions in Financing Transactions*, 87 GEO. L.J. 2225, 2244-45 (1999) ("Thus, lenders might take a lien on collateral expecting that the disastrous losses from repossession and liquidation by the lender would induce the borrower to repay the loan even if repayment alone is not value-increasing for the borrower at the time payment comes due. Although different scholars have different perspectives on the question, some scholars believe that much of the force of secured credit comes from the leverage that the lender holds in that transaction: repossession and liquidation cost the borrower much more than they aid the lender.").

⁶³ Parrish webinar, *supra* note xx (stating title loans are predatory because they are asset-based and not based on borrower's ability to repay); David Ress, *Draft Regulations for Car-Title Loans Draw Lenders' Fire*, RICHMOND TIMES DISPATCH (VIRGINIA), Nov. 4, 2009, at B3 ("Banning car-title loans on cars already being financed 'would reduce the opportunity for aggressive lenders to lure borrowers into loans which they are not capable of repaying,' the group's lawyer, David W. Clarke, added."); Fox & Guy, *supra* note xx, at 2 ("Lenders don't run credit checks or base loans on the borrower's ability to pay. Loans are generally due in one month, with interest only renewals available."); Martin & Adams, *supra* note xx, at 6 ("[T]he amount of each loan is unrelated to a person's income in any way shape or form. The amount is based solely on the value of the vehicle used as collateral.").

⁶⁴ Governor Lynch's Veto Message Regarding SB 57 July 6, 2011 <http://www.governor.nh.gov/media/news/2011/070611-sb57.htm> (last visited July 7, 2011) ("At the same time,

On the other hand, the title lenders assert they try to make repayment manageable. The lenders I interviewed all said they consider customers' ability to repay,⁶⁶ and some lenders' websites tell customers to bring proof of income, which suggests they consider ability to repay.⁶⁷ EZCORP's annual report tells investors that "[l]oan amounts are established based on customers' income levels, an inspection of the automobile and title and reference to market values of used automobiles."⁶⁸ An industry trade organization, the American Association of Responsible Auto Lenders, states in its best practices that its member "keep consumers' payments low enough so they are able to successfully pay off the loan"⁶⁹ Texas-based TJD Financial Services goes farther than most lenders by requiring a four page application that lists not only income but also all liabilities so that it can ensure the customers can repay their obligations.

Ultimately, it is impossible to know whether title lenders are actually evaluating borrowers' ability to repay without data from lenders that show customers' income, loan amounts, and other debt obligations. A less direct approach involves looking at whether people pay off the loans or sacrifice payments to other creditors to repay their title loans. These questions are taken up in Parts I.C.1 and I.C.4.

2. Are title borrowers overly optimistic about rollovers?

companies would be allowed to loan without any inquiry into a borrower's ability to repay the loan and would even be allowed to loan to people receiving local welfare assistance.”).

⁶⁵ See *In re TitleMax Holdings, LLC*, 447 B.R. 896 (Bkrcty. S.D.Ga. 2010.) (“The essential allegations were that the Defendant had violated South Carolina Consumer Protection Code, S.C.Code Ann. § 37-5-108, which provides that if a loan is unconscionable or is induced by unconscionable conduct the court may strike the entire agreement or the unconscionable terms within it. Plaintiffs allege that the unconscionability is evidenced by their belief that the Defendant knew or should have known that the borrower was unable to make the scheduled loan payments, and that it had failed to ascertain the ability to repay through a loan credit check and an evaluation of the borrower's debt to income ratio.”).

⁶⁶ Reich Interview, *supra* note xx (stating his company asks about income to make sure the customer can pay monthly amount); Anonymous Interview, *supra* note xx (“We always consider the customer’s ability to repay at the time of [the] loan, as we try to ensure that the customer’s payment obligation to us will be something that fits comfortably into his/her budget. An applicant must provide information about their monthly income as well as other indebtedness.”); Davis & Davis Interview, *supra* note xx (emphasizing the central importance the company places on the customer’s ability to repay); Vaugh & Bourns Interview, *supra* note xx (noting the Cash America’s product was designed to ensure the customer could pay off the loan).

⁶⁷ See Auto Cash USA, Car Title Loan Required Items, <http://www.autocashusa.com/title-loan-required-items.php> (“When you visit one of our licensed vendors' title loan stores, please bring the following: •Clear Car Title •Driver's license or state-issued I.D. card •Proof of Income •Vehicle for an inspection”) (last visited October 4, 2009)

⁶⁸ EZCORP, Inc., *supra* note xx, at 6.

⁶⁹ American Association of Responsible Auto Lenders, AARAL Best Practices Safeguard Consumers, at <http://www.responsibleautolenders.org/bestpractices/> (“AARAL member companies keep consumers’ payments low enough so they are able to successfully pay off the loan and get their title back.”).

One important concern about title lending is whether borrowers are overly optimistic when they begin the title lending transaction about how many times they will rollover or renew the loan. If borrowers are making poor decisions because they misjudge their future conditions, regulators could intervene to correct these errors. Academics make the claim that borrowers do not understand “the consequences of their lending arrangement.”⁷⁰

The optimism bias is one of the most robustly established biases in the literature on behavioral economics.⁷¹ It would not be surprising if people are overly optimistic about the likelihood they will pay off their title loans with few rollovers. Social scientists use a variety of methods to establish that people are overly optimistic in specific situations, but one method is to ask people about their expected outcomes in a situation and compare their expected outcomes to the actual outcomes of people in the same situation.⁷²

In the title lending survey, we asked customers “How many months total do you anticipate it taking you to completely pay off this loan (after all renewals/rollovers)?” Since we spoke to people who were just taking out a loan that day as well as people who had been rolling over for some time, I report here only the people who had just completed taking out a loan or had had it out just one month, which was 18 customers. Among those, 33.33% (n = 6) predicted taking one month to pay off the loan, 27.78% (n = 5) predicted taking 2 months, 22.22% (n = 4) predicted taking 3 months, 11.11% (n = 2) predicted taking 4 months, and 5.56% (n = 1) predicted taking 5 months. Because virtually all accounts suggest higher numbers of rollovers among actual borrowers in similar situations,⁷³ the people we surveyed were overly optimistic about the likelihood they would pay off their loan quickly.

3. Costs of Title Loans

⁷⁰ Ronald H. Silverman, *Toward Curing Predatory Lending*, 122 BANKING L.J. 483 (2005). One news story pointed out that title lending customers operate on a “false hope.” Arnold, *supra* note xx. In the context of payday lending, however, scholars have expressly stated borrowers are overly optimistic about how many times they will rollover their loans. E.g., Oren Bar-Gill & Elizabeth Warren, *Making Credit Safer*, 157 U. PA. L. REV. 1, 44 (2008); Alan White, *Behavior and Contract*, 27 LAW & INEQ. 135, 161-62 (2007).

⁷¹ Ron Harris & Einat Albin, *Bankruptcy Policy in Light of Manipulation in Credit Advertising*, 7 THEORETICAL INQ. L. 431, 434 (2006).

⁷² E.g., Lynn A. Baker & Robert E. Emery, *When Every Relationship is Above Average: Perceptions and Expectations of Divorce at the Time of Marriage*, 17 LAW & HUM. BEHAV. 439, 443 (1993).

⁷³ A variety of different lengths of payoff time have been reported by industry insiders and state regulators. 2008 Tenn. Report at 6 (reporting 7 rollovers on average in Tennessee); Parrish webinar, *supra* note xx (recounting that the CEO of TitleMax said people renew 8 times on average); AARAL, Best Practice, at <http://www.responsibleautolenders.org/bestpractices/> (“Most loans are paid back in six months or less.”). *But see* Anonymous Interview, *supra* note xx (“Most customers have paid off their loan within 90 days.”).

The high cost of title lending is a central concern of policymakers, judges, opponents of title lending, and anyone attempting to understand how to regulate the product.⁷⁴ Information about the average of title loan interest rates is frequently reported. Jean Ann Fox and Elizabeth Guy report a median rate of “25 percent per month finance charge, which translates to 300 percent annual interest, plus \$25 per loan.”⁷⁵ Without a doubt, interest rates are high.

Members of Congress have expressed concern that title borrowers “are unaware of applicable rates,”⁷⁶ but one study of title lending argues that title loans “have highly transparent and easily understood pricing schemes.”⁷⁷ The people we surveyed did not exhibit an understanding of the high relative cost of title loans compared to credit card debt. Only 25.71% (n = 9) recognize that a title loan is a lot more expensive than credit card debt, while 17.14% (n = 6) thought a title loan is a lot less expensive than credit card debt, 5.71% (n = 2) thought a title loan was a little less expensive than credit card debt, and 31.43% (n = 11) thought the two were about the same cost. While this small sample of people may not be indicative of borrowers generally, it is disturbing how few people understood the relative cost of their title loan.

While customers might not understand the cost of title loans relative to credit cards, it appears firms do compete for business based on price. It is often repeated that fringe banking companies compete on nonfinancial bases such as convenience and friendliness.⁷⁸ Title lenders themselves note the important role nonfinancial issues such as staffing, location, and the cleanliness of facilities play in capturing business.⁷⁹ Some academics go farther to claim that there is virtually no price competition in fringe lending markets like payday lending.⁸⁰

⁷⁴ TMX Finance LLC, Form S-4 (Dec. 31, 2010), at 21 (“The consumer advocacy groups and media reports generally focus on the cost to a consumer for this type of loan”); Governor Lynch’s Veto Message Regarding SB 57 July 6, 2011 <http://www.governor.nh.gov/media/news/2011/070611-sb57.htm> (last visited July 7, 2011) (“I am vetoing this legislation [which would raise the interest rate above 36% for title loans] because legalizing excessive interest rates for title loans - rates of 300 percent APR - would be detrimental to our families, our communities, and to our economy.”); *Wisconsin Auto Title Loans, Inc. v. Jones*, 714 N.W.2d 155, 179 (Wis. 2006) (Judge Louis Butler, concurring) (“Predatory lenders exploit borrowers through excessively high interest rates.”).

⁷⁵ Jean Ann Fox & Elizabeth Guy, *Driven into Debt: CFA Car Title Loan Store and Online Survey*, CONSUMER FEDERATION OF AMERICA, at 2, available at http://www.consumerfed.org/pdfs/Car_Title_Loan_Report_111705.pdf.

⁷⁶ 146 CONG. REC. H5179-02 (daily ed. June 27, 2000).

⁷⁷ Zywicki, *supra* note xx, at .

⁷⁸ See, e.g., Zywicki, *supra* note xx, at (“[N]ontraditional lenders compete intensely on nonfinancial margins: As noted, they offer longer hours, they provide highly-personalized customer.”); Robin A. Prager, *Determinants of the Locations of Payday Lenders, Pawnshops and Check-Cashing Outlets*, Federal Reserve Board Finance and Economics Discussion Series (2009) at 15 (arguing alternative financial service providers locate near customers).

⁷⁹ See Reich Interview, *supra* note xx (noting the importance of having a visible location and treating customers well); Anonymous Interview, *supra* note xx (“We rely on television and radio marketing, friendly and trust-worthy service, [and] attractive locations in accessible parts of town.”); EZCORP, Inc., *supra* note xx, at 11 (“We believe that the primary elements of competition are the quality of customer service and relationship management, store location and the ability to loan competitive amounts at competitive rates.”); Titlemax Disclosure Statement, *supra*

The truism that borrowers are insensitive to price, however, does not appear to apply to title lending because price seems to play a key role in obtaining business. TitleMax publicly disclosed to its creditors that its success is due in part to the fact it “charge[s] as much as fifty percent (50%) below the interest rates charged by their competitors.”⁸¹ Similarly, EZCORP tells investors that competitive pricing is a “primary element[] of competition.”⁸² Title lenders’ advertisements confirm the importance of price in competition. Some lenders emphasize cost in their advertisements: “[Y]ou’re also certain you’re getting the lowest guaranteed interest rates anywhere in Texas on your car title loans! To go from a high-interest short period to a low-interest long period, you can always have your car title loan refinanced with us.”⁸³ Some companies even make cost comparisons for customers between themselves and other companies.⁸⁴

Different companies appear to offer different rates. In Tennessee, regulators determined that 53% of companies charged 22% APR, the maximum rate allowed by law, while the other 47% of companies charged between 10% and 21% APR.⁸⁵ In Oregon in 2006, before interest rates were capped at 36%, the maximum rate charged was 663% but the average rate was

note xx, at (“The success of the Debtors’ business is attributable to several factors including, but not limited to . . . the Debtors employ a highly motivated and well trained sales force that accurately judge the appropriate amount of the Customer Loan [and] the Debtors have highly visible locations and brand recognition.”).

⁸⁰ ROBERT MAYER, *QUICK CASH: THE STORY OF THE LOAN SHARK* (2010).

⁸¹ Titlemax Disclosure Statement, *supra* note xx, at XX.

⁸² EZCORP, Inc., *supra* note xx, at 11.

⁸³ Sugar Land Car Title Loans, Best Texas Vehicle Title Loans In Sugar Land, <http://www.sugarlandtitleloans.com/index.html> (last visited Aug. 18, 2011). See also Magnolia Loans, Tile Loan FAQ, <http://www.magnolia-loans.com/faqs/title-loan-faqs/#586>, (last visited Aug. 18, 2011) (“Q: How is Magnolia so much cheaper than other title loan stores? A: It’s simple really. We have fewer expenses than most title loan stores and don’t have to charge as much to cover our costs. It also helps that we are honest and straightforward and believe in making quality loans that people can afford to pay back.”),

⁸⁴ See Advantage Finance, LLC, Houston Car Title Loans From Advantage Finance LLC, <http://www.cartitleloanshouston.com/> (last visited Aug. 18, 2011) (comparing itself to two other types of title loan products).

⁸⁵ 2009 Tenn. Report, *supra* note xx, at 10-11.

318%.⁸⁶ As a local example, companies in Houston charge rates ranging from 217.7%⁸⁷ to 144.95%⁸⁸ to 114.0%.⁸⁹

C. Cars as Collateral

The central objection to title lending relates to the use of the consumer's vehicle as collateral for the loan. This section explores some of the factual issues underlying this objection.

1. How often do lenders repossess vehicles?

There is a lot of questionable or unclear data about how often title lenders repossess cars. Many sources, including members of Congress,⁹⁰ assert without offering any proof that lenders "often" repossess people's cars.⁹¹ Even some of those interpreting evidence about repossessions have reported misguided information about how often lender repossess vehicles.

For instance, in a 2007 law review article, Jean Ann Fox claims, based on reports generated by Tennessee's Department of Financial Institutions, that between 35% to over 50% of loans in Tennessee result in the title lender repossessing the vehicle.⁹² To come up with this figure, she took the total number of title loan agreements reported in Tennessee and divided it by

⁸⁶ 2006 Oregon Report.

⁸⁷ Texas Title Loans, WELCOME TO TEXAS TITLE LOANS!, at <http://txtitleloans.net/> (last visited Sept. 12, 2011).

⁸⁸ EZCORP has a store at 8502 Main St. # D, Houston, Texas that on September 1, 2011 was publicly advertising title loans at "12%" (presumably a month).

⁸⁹ Advantage Finance, LLC, Houston Car Title Loans From Advantage Finance LLC, <http://www.cartitleloanshouston.com/> (last visited Aug. 18, 2011).

⁹⁰ 146 CONG. REC. H5179-02 (daily ed. June 27, 2000) (statement of Representative Mascara) ("At such a high interest rate, *many* of these [title loan] borrowers are unable to pay off their loan and their vehicles are repossessed.") (emphasis added).

⁹¹ DeGaris, *supra* note xx ("A title loan *often* ends in repossession.") (emphasis added); Arnold, *supra* note xx ("Fox of the CFA says: 'They purposely target borrowers who cannot afford the high-cost, short-term balloon loans, virtually guaranteeing that *many* of the loans will fail'" (emphasis added); *Newest Form of Predatory Lending Strikes*, NEWS & ADVANCE, Dec. 10, 2008, http://www2.newsadvance.com/Ina/news/opinion/editorials/newest_form_of_predatory_lending_strikes/11370 ("Another consequence of car title loans is a high repossession rate."); Silverman, *supra* note xx ("In cases of default, lenders are quick to repossess and sell the car").

⁹² Jean Ann Fox, *Fringe Bankers: Economic Predators or New Financial Services Model*, 30 WESTERN NEW ENGLAND L. REV. 135, 140 (2007) ("Consumers who pledge car titles as security for small loans run the risk of losing their vehicle. For example, Tennessee regulators reported that 10,933 vehicles were repossessed for nonpayment in 2005 out of a total 92,489 loan agreements. If every Tennessee borrower renews a loan just three times, that is a 35% repossession rate. If every loan is renewed seven times, as indicated by an earlier Tennessee Department of Financial Institutions report, more than half of the cars pledged for loans are eventually lost by borrowers.").

the number of times customers rollover or renew the loans on average.⁹³ She compared that figure to the number of repossessions and concluded that the repossession rate is between 35% and 50%, depending on whether we assume borrowers rollover their loans three or seven times.⁹⁴

The problem with this analysis is that the Department of Financial Institutions considers the “total number of title loan agreements” to mean only new agreements, not renewals or rollovers. Although later reports make it explicit,⁹⁵ the report Fox was using is unclear on this point, so her confusion is understandable.⁹⁶ The employee responsible for creating the report in Tennessee, however, confirmed to me that the number of agreements did not include rollovers in that report either.⁹⁷ Thus, in determining the repossession rate, we should not divide the number of loans by the average rollovers. Fox’s repossession rates are inflated three to seven times the real amount.

Similarly, an influential report from the Woodstock Institute finds 18% of title loans in Illinois end in repossession.⁹⁸ The actual repossession rate is higher, the report argues, because this figure does not include “repossessions that occur immediately after default where a court case is not filed by the lender.”⁹⁹ The problem, however, is that this repossession rate is not calculated based on all the title loans in Illinois but merely reflects the repossession rate in cases where the lender sued to collect money from the borrower.¹⁰⁰ Cases in collection likely have a different repossession rate than cases outside collection. Moreover, cases with loans that have sufficiently high values to encourage a suit likely have different repossession rates than the general population of title loans. Thus, the Woodstock Institute report does not provide any evidence of the repossession rate for all title loan agreements.

⁹³ *Id.*

⁹⁴ *Id.*

⁹⁵ The report generated in 2008 concerning data from 2006 explicitly states about the “total number of title pledge agreements” that “[t]his figure reflects new agreements made and does not include renewals of these initial agreements.” Tenn. Dept. of Fin. Inst., *The 2008 Report on the Title Pledge Industry 4* (February 20, 2008) <http://www.tn.gov/tdfi/compliance/tpl/TPLReport2008FinalFinal.pdf>

⁹⁶ See <http://www.tennessee.gov/tdfi/compliance/TPLSupplementalReport-FINAL.pdf> (stating the total title pledge agreement figure without explaining whether it incorporates rollovers into that figure or not).

⁹⁷ Email from Steve Henley, Tenn. Dep’t. of Fin. Inst., to Jim Hawkins (Aug. 4 2011, 14:33 CST) (on file with author).

⁹⁸ WOODSTOCK INSTITUTE AND PUBLIC ACTION FOUNDATION, *DEBT DETOUR: THE AUTOMOBILE TITLE LENDING INDUSTRY IN ILLINOIS 3* (2007).

⁹⁹ *Id.*

¹⁰⁰ See *id.* (explaining the statistics generated in the report are based on an analysis of cases filed against title borrowers).

Nathalie Martin and Ozymandias Adams report in a new paper based on reports from New Mexico that “between 20% and 71% of the title loan customers have their vehicles repossessed.”¹⁰¹ Martin and Adams’ calculations rely on the summary data in the New Mexico reports, and they use this data to calculate various averages. Important here, they calculate the average amount of each loan by comparing the total principal for all loans originated during the calendar year to the total principal amount outstanding on all loans at the end of the calendar year.¹⁰² They calculate the number of loans per year (a number omitted from the New Mexico report but present in almost all other state reports) by dividing the total amount of principal by the average loan amount.¹⁰³ Finally, they use the average times a person took out a new title loan that the state generates.

To calculate how often people lose their vehicles, Martin and Adams divide the total number of loans (a figure generated through computing the average size of each loan) by the average number of times a person took out a new loan. Then, they divide the quotient by the number of repossessions in the year.¹⁰⁴

Beginning with such estimated data leads to two fundamental computational problems. First, as Martin and Adams note, “[o]ne problem with the yearly summaries is that they average all of the data, including obvious outliers.”¹⁰⁵ This introduces some unknown error rate into each original average. Once two such averages are combined to perform a calculation, the error rate is compounded.

Second, Martin and Adams perform their computations under the assumption that dividing the averages of two variables results in a third average—the average of the divided variables. This is not true.¹⁰⁶ As a result of beginning with averaged data, Martin and Adams have no choice but to reverse the correct order of arithmetic in averaging, resulting in potentially skewed final numbers.

¹⁰¹ Martin and Adams, *supra* note xx, at 4.

¹⁰² *Id.* Table 4.

¹⁰³ *Id.* Table 14.2.

¹⁰⁴ *Id.* Table 14.2.

¹⁰⁵ *Id.* Table 14.2.

¹⁰⁶ For instance, say Variable A has data points {1, 3, 5} and Variable B has data points {2, 4, 6}. The average of Variable A is 3 and the average of Variable B is 4. Thus (the average of Variable A) divided by (the average of Variable B) is $3/4$ or $27/36$. This is not the same as the average of (Variable A divided by Variable B). (Variable A divided by Variable B) results in the set $\{1/2, 3/4, 5/6\}$ with an average of $25/36$. The former method is the one employed by Martin and Adams, while the latter is the more mathematically sound.

Finally, Todd Zywicki finds that around 8% of loans lead to repossession based on state reports and interviews with title lending companies.¹⁰⁷ Based on his discussion of this repossession rate, however, it is unclear if Zywicki is reporting the number of new title loan agreements that led to repossession or the number of renewals or rollovers that led to repossession.¹⁰⁸ Based on the data I report below, it appears that Zywicki is reporting repossessions per new loan agreement, but it is not entirely clear.

To attempt to understand how often customers lose their vehicles, I interviewed title lenders and evaluated reports generated by state regulators. One title lender informed me that its database tracks repossession rates per customer,¹⁰⁹ and that 5 to 6% of customers lose their vehicles.¹¹⁰ News stories report the nation's largest lender stating the repossession rate per customer is 7%.¹¹¹ A smaller operator in Texas told me that they repossess around 10% of customers vehicles but that customers redeem the vehicles 6-7% of the time, resulting in 3-4% of people losing their vehicles.¹¹²

I have combined the data from the six states' reports I obtained in Table 2 below. None of the states state how many new loan agreements a customer takes out on average a year, so it is impossible to know how many customers lose their vehicles from title lending. But, these figures do not include rollovers or renewals under the "number of title loans," so the repossession rates reported below are rates per new title lending agreement.¹¹³

¹⁰⁷ Zywicki, *supra* note xx.

¹⁰⁸ See Adam Levitin, Auto Title Lending Data, www.CreditSlips.org, <http://www.creditslips.org/creditslips/2011/01/auto-title-lending-data.html> ("They also seemed highly skewed by the fact they were counting loans rather than borrowers. Title loans are 30-day loans that can be rolled over, but a roll-over counts as a new roll, which effectively inflates the denominator for default rates.).

¹⁰⁹ Anonymous Interview, *supra* note xx;

¹¹⁰ Email from Anonymous Title Lender Interviewee, to Jim Hawkins (Jan. 1 2011, 15:13 CST) (on file with author) ("Our average national repossession rate is between 5 and 6%. This is based on a ratio of repossession per customer not loans.").

¹¹¹ Richard Locker, *No Progress on Title-Lending Bill: Coalition, Industry Pitch Sides, but Panel OKs Nothing*, KNOXNEWS.COM, Jul. 23, 2008, available at <http://www.knoxnews.com/news/2008/jul/23/no-progress-on-title-lending-bill/?printer=1/> ("The vice president of Atlanta-based Community Loans of America said . . . that 'only 7 percent of customers had their cars seized . . .'). For another report not based on repossessions per customer, see Sue Kirchhoff, *Some Consumers Run into Big Problems with Auto Title Lending*, USA TODAY, Dec. 27, 2006, available at http://www.usatoday.com/money/perfi/general/2006-12-26-title-loans-usat_x.htm ("Rod Aycox, president of LoanMax auto title and its affiliated companies throughout the country, made about half a million loans this year and repossessed cars in 5% of the cases, or 25,000 autos, according to a statement from his firm.").

¹¹² Davis & Davis Interview, *supra* note xx.

¹¹³ I have emails from regulators in Tennessee and Montana that confirm the number of loan agreements does not include rollovers or renewals. Email from Steve Henley, Tenn. Dep't. of Fin. Inst., to Jim Hawkins (Aug. 4 2011, 14:33 CST) (on file with author); Email from Linda Leffler, Montana Division of Banking and Financial Institutions, to Jim Hawkins (Aug. 5, 2011, 16:57 CST) (on file with author). The Illinois report plainly does not

Because some customers take out more than one new loan a year, the repossession rate per customer could be higher. We do know, however, that the repossession rate per customer is not much higher than the repossession rate per new loan because the length of loans reported in different states are all quite high. Few customers could have more than one loan out in the year.

Table 2: Repossession Rates on New Title Loans

<u>State</u>	<u>Year</u> ¹¹⁴	<u>Number of New Title Loan Agreements</u>	<u>Number of Repossessions</u> ¹¹⁵	<u>Repossession Rate</u>
Tennessee ¹¹⁶	2008	161,417	14,832	9.18%
	2007	139,319	18,199	13.06%
	Nov. 2005 – June 2006	92,489	10,933	11.82%
	2004	250,593	17,313	6.91%
Oregon ¹¹⁷	2009	17,820	2	0.01%
	2008	10,136	1	0.00%
	2007	8,568	32	0.37%
	2006	15,726	125	0.80%
	2005	17,801	114	0.64%

count renewals as different loans because it states that the average length of time the borrower had a loan was over 300 days, which reflects multiple renewals of a single loan. The Oregon report lists rollovers separately from total loan agreements, indicating the former does not include the latter. And, for some years in Oregon, rollovers were prohibited, so the total number of loans could not include rollovers. The Virginia report says the average number of days customers had loans was 305, which indicates the loan number includes rollovers.

¹¹⁴ The year represents the year the data were gathered, not the year the data were reported.

¹¹⁵ These figures exclude cases where customers redeemed repossessed collateral because in those cases customers did not lose their vehicles.

¹¹⁶ These reports can all be accessed at Title Pledge Reports, Tennessee Department of Financial Institutions, available at <http://www.tn.gov/tdfi/compliance/tpl/TPLreports.html>

¹¹⁷ These reports can all be accessed at Oregon, Division of Finance and Corporate Securities, available at http://www.cbs.state.or.us/external/dfcs/activity_reports/consumer_finance.html

Idaho ¹¹⁸	2010	34,247	2382	6.96%
Illinois ¹¹⁹	Oct. 2009 – June 2011	155,094	7,334	4.73%
Montana ¹²⁰	2009	12,727	599	4.71%
Virginia ¹²¹	Oct. 2010 – Dec. 2010	24,975	194 ¹²²	0.78%

Based on the information in Table 2, the repossession rates in these six states are much lower than previous research has indicated.

2. Are borrowers overly optimistic about the chances their vehicle will be repossessed?

It is possible that lenders frame the transaction to minimize customers' awareness of the potential loss of their vehicles.¹²³ Borrowers might think the risk of losing their car is lower than it really is, so they undervalue the risk when making the decision whether to enter into the transaction. Put another way, borrowers might be "operating on false hopes" regarding whether their car will be repossessed.¹²⁴ The facts that borrowers do not have to turn over their vehicle or even their title to the vehicle in some cases has led some commentators to theorize that borrowers do not feel the potential loss at the time of the transaction.¹²⁵ Legislators have even

¹¹⁸ On file with author.

¹¹⁹ On file with author.

¹²⁰ On file with author.

¹²¹ Virginia Report, *supra* note xx.

¹²² This number likely overstates the number of vehicles consumers lost because the report states only 2 vehicles were sold by lenders, indicating customers redeemed some repossessed vehicles. *Id.*

¹²³ See Patricia A. McCoy, *A Behavioral Analysis of Predatory Lending*, 38 AKRON L. REV. 725, 731 (2005) ("[P]redatory lenders go to extreme lengths to frame their loans as gains and to obscure potential losses.").

¹²⁴ Arnold, *supra* note xx.

¹²⁵ Jean Braucher, *Theories of Overindebtedness: Interaction of Structure and Culture*, 7 THEORETICAL INQ. L 323, 332 (2006) ("Title 'pawn' loans allow consumers to get non-purchase-money secured auto loans, without the cautionary event of a transfer of possession but with the risk of losing a car used to get to work."); Dave Ress,

argued that title lenders deceive borrowers about the likelihood their car will be repossessed: “These pay-day loans, title loans, where you come in and hand the title of your car over and they give you a basic loan and say: We are not going to take your car away. The next thing you know, interest rates are going up, you refinance the loan, and pretty soon you may lose your car.”¹²⁶

To test whether borrowers are overly optimistic about the likelihood their car would be repossessed, I asked them “What do you think is the percentage chance the lender will repossess your vehicle?” Unlike my analysis of optimism for rollovers, I include all responses here, regardless of how long the customer had had the loan out. 54.29% (n = 19) of those we surveyed predicted there was a 0 percent chance the lender would repossess their vehicle, 2.86 (n = 1) predicted a 5% chance, while 40% (n = 14) predicted a 10% or greater chance their vehicle would be repossessed.¹²⁷ For borrowers taking out a loan the date they were surveyed, 75% (n = 6) predicted a 0% chance they would lose their vehicle. Regardless of which state’s or lender’s data we use, most of the people we surveyed exhibited too optimistic of view of whether the lender would repossess their vehicle.

3. Do lenders use collateral as a terror mechanism to encourage repayment?

Even if lenders do not actually repossess borrowers’ vehicles, some commentary on title lending suggests that the mere threat of repossession is sufficient to cause borrowers to continue to make payments on the title loan. More specifically, opponents argue that using vehicles as collateral causes borrowers to prioritize their title loan payments over other bills¹²⁸ and gives

Proposed Regulations for Car-title Loans Draw Fire, RICHMOND TIMES-DISPATCH, Nov. 4, 2009, available at http://www2.timesdispatch.com/business/2009/nov/04/b-payd04_20091103-211405-ar-15441/ (“A borrower . . . should be fully aware that that he has given the lender a lien on his vehicle and that he may lose his vehicle if he doesn’t repay the loan,” the center’s executive director, James W. Speer told the commission. “This will not necessarily be clear to the borrower unless he is required to surrender his title.”).

¹²⁶ 156 CONG. REC. S3016-03 (daily ed. May 3, 2010) (statement of Senator Durbin).

¹²⁷ 4 people predicted a 10% chance, 1 person predicted a 15% chance, 2 people predicted a 20% chance, 1 person predicted a 30% chance, 2 people predicted a 50% chance, 1 person predicted a 70% chance, and 2 people mysteriously predicted a 100% chance. Two people did not answer this question.

¹²⁸ DEP’T OF DEFENSE, REPORT ON PREDATORY LENDING PRACTICES DIRECTED AT MEMBERS OF THE ARMED FORCES AND THEIR DEPENDENTS 7, 44 (Aug. 9, 2006) [hereinafter “DEP’T OF DEFENSE REPORT”], available at http://www.defenselink.mil/pubs/pdfs/Report_to_Congress_final.pdf (“[Car title pawns] provide undue and coercive pressure on military borrowers and allow lenders more latitude in making loans without proper regard for the Service member’s ability to repay. . . . The use of . . . car titles pressure the borrower to consider loan payments as being their top priority.”); Parrish webinar, *supra* note xx (arguing that title loans cause borrowers to drop their other bills to make sure they pay on their title loan); Speer webinar, *supra* note xx (reporting that two people seeking legal help claimed they would pay their car title before they paid their rent).

lenders substantial bargaining leverage over borrowers.¹²⁹ It is not the value of the vehicle that compels repayment but instead the cost of purchasing a replacement.¹³⁰

The fact some lenders in Virginia used to take out a second lien on a vehicle, which would not allow them to actually recover anything, provides some evidence of the role terror could play in title loan transactions.¹³¹ Yet, the value of the vehicle sets the amount of the loan in most cases. Thus, lenders must not view the collateral merely as a means of forcing repayment because they use it as a baseline for how much to lend.

To test the coercive force of using a vehicle as collateral, I asked customers “If you couldn’t pay off all your bills one month, which bills would you NOT pay so you could pay on this loan?” and we provided various categories. Table 3 reports the results.

Table 3: Bills Borrowers Would Not Pay in Order to Pay Title Loan

Bill	Percentage	Number
Rent or Mortgage Payment	5.71%	2
Utilities	5.71%	2
Credit card debt	62.86%	22
Groceries	11.43%	4
Medical	11.43%	4
Other, including pet bill, cable bill, internet service, cellular phone bill	22.86%	8

Table 3 indicates the people we surveyed would not prioritize their title loan payments over their basic necessities such as rent, utilities, groceries, or medical expenses. The survey does suggest the people we surveyed prioritize paying the title lender before their credit card company, but this preference does not indicate title borrowers are terrorized into prioritizing their title loan payments.

4. Do customers have other transportation to work?

A central factual question in the policy debates about title lending is whether people taking out title loans have other means of transportation. This issue is important because if title

¹²⁹ DEP’T OF DEFENSE REPORT, *supra* note xx, at 7. See also Mattson, *supra* note xx (asserting that title lenders use the powerful leverage of repossession over consumers in negotiations to set up repayment plans).

¹³⁰ Speer webinar, *supra* note xx.

¹³¹ Speer webinar, *supra* note xx (arguing that some lenders, like Advance America, in Virginia did title loans with a second lien on the vehicle to make borrower think the lender can take the car and sell it despite the fact that Virginia law does not allow lenders to take a second lien on a vehicle).

loans cause people to lose their jobs or fail to show up to doctors' appointments, it is much easier to link title lending to other social ills.

It is hard to overstate how important this issue is to policymakers considering title lending. Consumer advocates make this argument the center of their strategy against title lending.¹³² Academic papers¹³³ and press reports¹³⁴ have also taken up the theme, reporting the argument that title loans are “more damaging than payday loans because borrowers who cannot pay the required fees lose their transportation to and from work.”¹³⁵

Most importantly, government officials have placed tremendous stock in the argument people will lose their only way to get to work. One Congresswoman asserted that repossessions by title lenders “often” result in the loss of a job.¹³⁶ The House of Representatives itself passed a resolution calling states to intervene in title lending markets because “title loans and title pawns

¹³² See Prepared Testimony of Daniel A. Edelman Regarding Payday and Title Loans, available at <http://www.edcombs.com/CM/News/news20.asp> (“No collateral should be permitted on these high-interest loans. There is no justification for 200 or 300% fully secured loans. Consumers who need automobiles to get to work and stay off welfare should not be losing their cars to ‘title lenders.’”); Jessica Hiemenz, National Consumer Law Center, Webinar: Baby, You Can Take My Car: The Dangers of Auto Title Loans (July 15, 2010), at <http://www.nclc.org/conferences-training/auto.html> (click on “Recording” under Baby, You Can Take My Car: The Dangers of Auto Title Loans) (noting the main concern of auto title lending is the risk of a car being repossessed); Barry Yeoman, *Sudden Debt?*, AARP THE MAGAZINE, Sep. 2006 (“They’re really devastating for elderly people who need their cars.”); *Loans Secured by Car Titles Trap Borrowers in Cycle of Debt*, CONSUMERAFFAIRS.COM, Apr. 18, 2005, http://www.consumeraffairs.com/news04/2005/car_loans.html (noting that the loans in “many cases” end in the repossession of the car “after the borrower has made substantial payments” and that this is “devastating because a car is often the borrower’s largest asset and his or her only way to get to work”).

¹³³ Fox, *supra* note xx, at 140. See also Braucher, *supra* note xx, at 332 (pointing out that title loans force borrowers to “risk of losing a car used to get to work”); Barr, *supra* note xx, at 166 (“With title lending, however, the borrower risks losing her car, which may be her regular way to get to work, and to transport children to and from school or child care.”).

¹³⁴ See Elinat Paz-Frankel, *Opponents of Auto Title Lending Industry Hope Legislature Limits ‘Outrageous’ Fees*, MEMPHIS BUS. J., Aug. 22, 2008 (“Cars are used as collateral for title loans” and “when vehicles are repossessed, borrowers often are left with no means of driving to work”); Kirchhoff, *supra* note xx (“If borrowers can’t pay back the loans, often due in 30 days, they often roll them over, with multiplying fees. If they still fall behind, their cars can be repossessed. That contributes to a downward spiral, with people unable to get to work, a doctor or drive their kids to school.”); *Newest Form of Predatory Lending Strikes*, NEWS & ADVANCE, Dec. 10, 2008, http://www2.newsadvance.com/lna/news/opinion/editorials/newest_form_of_predatory_lending_strikes/11370 (“A lobbyist for LoanMax said that reducing the rate to 36 percent would effectively put the company out of business. So be it. Such an alternative is far preferable to preying on the poor at the ultimate expense of depriving them of their only means of transportation.”).

¹³⁵ Jeff Peterson, MBA, *Predatory Lending: Profile & Analysis*, ARIZONA RURAL POLICY INSTITUTE NORTHERN ARIZONA UNIVERSITY, Aug., 8, 2007, at 5. Burt et al, *supra* note xx, at 21 (“Unlike the loss of a television or other electronic good, the loss of a car because of a default on a loan can have extensive ramifications for a person who needs the car for work, grocery shopping, care of children, and other daily necessities.”).

¹³⁶ 146 CONG. REC. H5179-02 (daily ed. June 27, 2000) (statement of Representative Mascara) (“As is the case for most Americans, these consumers depend on their automobiles and trucks for transportation to their jobs, vital medical appointments, and school for their children. So the loss of a vehicle through an unfair foreclosure often results in the loss of a job or other serious consequences.”).

threaten the ability of consumers to hold a job since default on the loan or pawn will result in repossession and sale of their car, which is often their only means of transportation to and from work.”¹³⁷ The Department of Defense, in its report urging Congress to take action to prohibit high cost loans to service members, stated that title loans endanger “essential transportation.”¹³⁸ Even judges have expressed concern that if “a payment is missed, the lender can start the process of taking the borrower’s vehicle, resulting in a loss of transportation to work and to obtain health care.”¹³⁹

Officials’ concerns about the risk of losing transportation have resulted in real-world consequences. The governor of New Hampshire recently vetoed a law that would have permitted title lending in the state because “[f]ailure to repay a loan could lead to seizure of the family car, which is often essential for family members to maintain employment.”¹⁴⁰ Wisconsin Governor Jim Doyle used his veto power to outlaw title lending in Wisconsin because “[a]uto title loans can result in individuals losing their vehicles due to failure to make timely payments on relatively small loan amounts, putting at high risk an asset that is essential to the well-being of working families.”¹⁴¹ The most common regulatory response, as demonstrated in the cases of Wisconsin and New Hampshire, is to ban title lending. In 2009 a representative from Wisconsin supported a ban on title lending because “most folks need that car for work, family, etc.”¹⁴²

Yet, despite the fact this claim is made repeatedly, there is absolutely no data, except for that generated by the industry discussed below, about whether people using title loans have more than one vehicle. Consumer advocates arguing against title loans concede we have no information about what vehicles people have to get to work.¹⁴³ The one data point that is public is from an internal survey of TitleMax customers which found that “[a]pproximately 70% of our customers own two or more vehicles.”¹⁴⁴ However, TitleMax has only released the conclusions

¹³⁷ 146 CONG. REC. H5179-02 (daily ed. June 27, 2000).

¹³⁸ DEPT OF DEFENSE REPORT, *supra* note xx at 16 (“The high cost and risk of car title loans traps borrowers in repeated loan renewals in order to keep from losing essential transportation and key family assets.”).

¹³⁹ Wisconsin Auto Title Loans, Inc. v. Jones, 714 N.W.2d 155 (Wis. 2006) (Judge Louis B. Butler, Jr., concurring).

¹⁴⁰ Governor Lynch's Veto Message Regarding SB 57 July 6, 2011
<http://www.governor.nh.gov/media/news/2011/070611-sb57.htm> (last visited July 7, 2011).

¹⁴¹ *Doyle's Veto Pen Is a Sword for Consumers*, THE CAPITAL TIMES (Madison, Wisconsin) May 26, 2010, at 29. For an explanation of how the Governor outlawed title lending through his veto power, see *Auto Title Lenders Decry Doyle Veto*, ST. PAUL PIONEER PRESS (Minnesota), May 19, 2010 (“Doyle on Tuesday used his partial veto power to cross out parts of several sections to create a new sentence declaring, ‘No licensed lender may make a title loan.’”).

¹⁴² Rep. Josh Zepnick, *Rep. Josh Zepnick: Let's Ban Auto Title Loans*, MADISON.COM, July 24, 2009, <http://www.madison.com/tct/opinion/editstaging/459554>.

¹⁴³ Parrish webinar, *supra* note xx.

¹⁴⁴ TMX Finance LLC, Form S-4 (Dec. 31, 2010), at 43.

of its survey, not any of the underlying methodology or data. Thus, this central question of title lending policy has been entirely unaddressed.¹⁴⁵

In my survey, I asked “Considering only people living in your same house, how many working vehicles does your family have?” Among those we surveyed, 20% (n = 7) had only one vehicle in their household. The remaining 80% had two or more vehicles, with the modal number (representing 62.86% of surveys) being 2 vehicles. If these results were representative, which of course I am not claiming they are, and the repossession rates presented in Part I.C.1 were representative, then the number of people losing their only way to work is small, around 2%. Because of the limitations on the data I acquired, this remains a question of central importance for title lending policy. My findings, however, cast serious question on the often repeated claim that title lending results in customers being unable to get to work.

States have had to craft regulatory policy for title lending despite the uncertainties that surround the fundamentals of this business. The next Part explains how different states have responded to title lending.

II. TITLE LENDING LAW

Several federal laws govern title lending, and these laws are well-known provisions. The Truth in Lending Act requires, among other things, that title lenders to disclose the cost of loans as an annual percentage rate.¹⁴⁶ The new Dodd-Frank Wall Street Reform and Consumer Protection Act forbids lenders from engaging “in any unfair, deceptive, or abusive act or practice,” and empowers to the Bureau of Consumer Financial Protection to develop regulations of title lenders.¹⁴⁷

Less explored and recognized are state statutes regulating title lending. States have adopted a wide variety of methods for regulating title lending. These cover an enormous range from explicitly banning the transaction to formally authorizing it with very few restrictions. This Part categorizes current regulatory approaches and analyzes these disparate schemes and their relationship to other laws not specifically governing title lending.

¹⁴⁵ Another important policy question that needs research is whether most of the cars lenders repossess work. Title lenders claim that most vehicles they repossess are essentially worthless. Davis & Davis Interview, *supra* note xx (estimating 90% of the vehicles they repossess are worthless); Zywicki, *supra* note xx, at xx (“[M]any of these cars have mechanical failures or other damage that makes it not worthwhile to expend the cost of repossession.”); Locker, *supra* note xx (“The vice president of Atlanta-based Community Loans of America said . . . that some customers who default have cars so worthless that they tell lenders to come get them.”). It is important to know whether the repossessed vehicles still function because if most do not, the claim that people are losing a means of transportation is obviously false. But, it is hard to believe lenders would spend the money to repossess nonfunctioning cars, suggesting people are losing a means of transportation.

¹⁴⁶ 15 U.S.C. §§1632 (2010).

¹⁴⁷ Consumer Financial Protection Act of 2010 § 1036 (available at http://financialservices.house.gov/Key_Issues/Financial_Regulatory_Reform/conference_report_FINAL.pdf). For a more extensive discussion of the importance of the Act for fringe creditors, see Jim Hawkins, *The Federal Government in the Fringe Economy*, 14 CHAP. L. REV. 23 (2011).

Creating categories of different types of state regulations is significant because while other articles have discussed title lending law generally,¹⁴⁸ no other articles have established such a taxonomy of existing title lending laws. Creating a taxonomy allows us to see the options available to regulators when confronting the problems and the opportunities created by title lending. This Part sets the groundwork for Part III, which evaluates these different approaches.

A. Bans and Effective Bans

Louisiana is the only state that explicitly bans all title loans in the state, although federal legislation has been introduced in an attempt to ban title loans across the nation.¹⁴⁹ The Louisiana Revised Statutes limit pawnbrokers to accepting vehicles as collateral only if they physically possess the vehicle, and the statute explicitly states: “Under no circumstances shall the practice commonly referred to as motor vehicle ‘title only’ pawn transactions be allowed in this state.”¹⁵⁰

Although Louisiana is alone in overtly forbidding title lending, a strong majority of states effectively ban title lending by setting usury rates low enough that no one will offer title loans within their borders. Alaska provides one of many examples.¹⁵¹ Alaska has a small loan law that applies for any loan under \$25,000.¹⁵² The statute caps loans under \$25,000 at a maximum of 3% a month,¹⁵³ which works out to roughly 42.5% APR. No statute in Alaska explicitly exempts title lenders from this cap,¹⁵⁴ and Alaska does not allow title lenders to offer title loans structured as open-ended credit agreements to evade the cap.¹⁵⁵ Thus, if a business wants to make a title loan, it is subject to the 42.5% APR cap.

¹⁴⁸ See Zywicki, *supra* note xx, at 434-435 (summarizing state laws at a high level); Martin & Adams, *supra* note xx, at 10 - 12 (discussing several individual state statutes without placing them into a broad conceptual framework).

¹⁴⁹ A federal ban on auto title lending was introduced by Arizona Representative Gabrielle Giffords. <http://giffords.house.gov/2010/06/us-rep-gabrielle-giffords-acts-to-ban-payday-lending-nationwide.shtml> . The text of the bill is available at <http://www.govtrack.us/congress/billtext.xpd?bill=h111-5689>

¹⁵⁰ LA. R.S. 37:1801(D) (2010).

¹⁵¹ For a few other examples, see COLO. REV. STAT. 5-2-201(2) (2010) (capping loans under \$1,000 at 36% APR); 9 VT. STAT. ANN. § 41a(4) (capping loans secured by vehicles at 20% APR).

¹⁵² ALASKA STAT. § 06.20.010 *et seq.* (2010).

¹⁵³ *Id.* at § 06.20.230.

¹⁵⁴ Alaska does exempt pawnbrokers from this statute, so it is possible that a business could make a title loan as a pawnbroker for less than \$500. See *id.* § 06.20.330(b) (“This chapter does not apply to individual loans by pawnbrokers or loan shops where separate and individual loans do not exceed \$ 500.”).

¹⁵⁵ See *id.* § 06.20.285(a) (“A licensee may make open-end loans not exceeding an aggregate total of \$ 25,000 and may contract for and receive interest on open-end loans as provided in AS 06.20.230 [setting 3% monthly rate maximums], and for other charges permitted under this chapter.”).

Title lenders refuse to offer title loans at 40% APR, so this rate cap effectively bans title lenders from Alaska and other states with similar laws. As one example, EZCORP's annual report explains that its stores do not lend to active duty military personnel because of the federal cap on these loans of 36%.¹⁵⁶ Evidence from states enacting interest-rate caps on payday loans after allowing higher rates makes it plain that lenders will not continue offering loans in these environments.¹⁵⁷ One consumer advocate has found that title lenders will generally only operate if they are permitted to charge above 200% APR.¹⁵⁸ Thus, when states enact caps at lower amounts, the effect is the same as Louisiana's law—a complete ban.¹⁵⁹

B. Title Lenders Operating in States with Strict Price Controls

Despite the fact interest rate caps should effectively ban title lenders from offering loans in a state, it is very difficult to determine whether any given interest rate ceiling is effective in preventing title lending. The National Consumer Law Center produced a scorecard on small dollar loan products in 2010 that lists which states prohibit title loans or set interest rates below 36%.¹⁶⁰ The Scorecard reports that 30 states fall within this category and should therefore have no title lenders.¹⁶¹ 20 states permit rates above 36%, but only 17 permit rates above 200%,¹⁶² the rate generally required to allow title lending to exist.¹⁶³ Yet, the American Association of Responsible Auto Lenders reports that its members alone operate in 22 states,¹⁶⁴ so determining which states effectively ban title lending is not as simple as merely looking at usury caps.

There are several states that have rate caps that should prevent title lending but that fail to do so because title lenders use creative legal moves to avoid the rate cap. Lenders have avoided

¹⁵⁶ EZCORP, Inc., *supra* note xx, at 14 (“This 36% annual percentage rate cap applies to a variety of loan products, including signature loans, though it does not apply to pawn loans. We do not make signature loans to active duty military personnel or their immediate families because it is not economically feasible for us to do so at these rates.”),

¹⁵⁷ Zywicki uses a report from Policis, THE EFFECT OF INTEREST RATE CONTROLS IN OTHER COUNTRIES 16 (Policis 2004), to make the point that after Florida capped interest rates for title loans at 30%, “the number of auto title lenders operating in the state dropped from 600 before the legislation was enacted to 58 the year following.” Zywicki, *supra* note xx, at 432 n. 17.

¹⁵⁸ Parrish webinar, *supra* note xx.

¹⁵⁹ Indeed, a consumer advocate recently pointed out that one the best way to ban title lending is placing a cap on interest rates. Speer webinar, *supra* note xx.

¹⁶⁰ National Consumer Law Center, Small Dollar Loan Products Scorecard—Updated (May 2010), at http://www.nclc.org/images/pdf/high_cost_small_loans/payday_loans/cu-small-dollar-scorecard-2010.pdf.

¹⁶¹ *Id.* at 14-20.

¹⁶² *Id.*

¹⁶³ Parrish webinar, *supra* note xx.

¹⁶⁴ American Association of Responsible Auto Lenders, About the AARAL, <http://www.responsibleautolenders.org/about/> (last visited July 23, 2010).

caps in Kansas by offering loans as open-ended credit arrangements, in Texas by operating as Credit Service Organizations, and in California by offering loans at amounts just above the amount covered by the rate cap. The following sections explain how these transactions work despite laws that appear to effectively ban them. In some cases lenders operate in the midst of uncertainty, realizing that courts may vitiate their loophole through a different interpretation of the law enabling it.

1. Open-Ended Credit

Kansas is a state with a 36% interest rate cap,¹⁶⁵ but it also has active title lending within its borders.¹⁶⁶ To avoid the cap and operate within Kansas, lenders structure title loans in Kansas as open-ended credit arrangements. In an open-end credit plan, like the plans credit cards use, the lender sets a credit limit, and the borrower can access any amount of money within that limit over a period of time, pay it off, and access it again, and the lender only charges a finance charge on the actual amount borrowed.¹⁶⁷ Title lenders in Kansas structure loans just like credit cards. One advertisement explains: “The title loan is an open-end line of credit that can be used as needed and paid back in full at any time”¹⁶⁸

Unlike normal loans, Kansas exempts open-ended credit from any cap: “For any consumer loan incurred pursuant to open end credit, including, without limitation, a loan pursuant to a lender credit card, a lender may charge a finance charge at any rate agreed to by the parties”¹⁶⁹ By simply restructuring the transaction, title lenders obviate the rate cap.

Lenders in Kansas are not alone in this practice. Up until recently, Virginia’s Finance Act had a similar loop hole that resulted in title lenders offering open-ended credit plans.¹⁷⁰ Similarly, reports indicate lenders in Iowa operated this way.¹⁷¹ Finally, lenders hoping to avoid

¹⁶⁵ See K.S.A. § 16a-2-401(2) (2009) (“(2) For any consumer loan incurred pursuant to closed end credit, a lender may charge a periodic finance charge, calculated accordingly to the actuarial method, not to exceed: (a) 36% per annum on the portion of the unpaid balance which is \$ 860 or less, and (b) 21% per annum on the portion of the unpaid balance which exceeds \$ 860”).

¹⁶⁶ For instance, Speedy Cash offers title loans in Kansas. Speedy Cash, Kansas Store Locations, <http://www.speedycash.com/payday-loans/kansas/locations/> (last visited July 26, 2010); Speedy Cash, Auto Equity Loans, <http://www.speedycash.com/auto-equity-loans/> (last visited July 26, 2010).

¹⁶⁷ For a legal definition, see Truth in Lending Act of 1968, 15 U.S.C. § 1602(i) (2010); 12 C.F.R. § 226.2(a)(20) (2010).

¹⁶⁸ Speedy Cash, Auto Equity Loans, <http://www.speedycash.com/auto-equity-loans/> (last visited July 26, 2010).

¹⁶⁹ K.S.A. § 16a-2-401(1) (2009).

¹⁷⁰ See *Attorney General Cuccinelli Sue Cash-N-A-Flash of Hampton for Excessive Interest Charges—Auto Title Lender Allegedly Violated Virginia Consumer Finance Act*, STATES NEWS SERVICE (May 18, 2010) (explaining that Virginia title lenders are subject to the state’s 12% rate cap if they do not offer credit as an open-ended credit plan).

¹⁷¹ Kirchoff, *supra* note xx.

the 36% rate cap on loans to military personnel are now offering open-ended “payday advances.”¹⁷²

2. Credit Service Organizations

Title lenders operating in Texas face a similar interest rate cap of 30% for loans under \$1,800.¹⁷³ Instead of offering loans directly to borrowers and thus being subject to this cap, most lenders operate as Credit Service Organizations (CSOs). CSOs are defined in the Texas Finance Code as a person who provides services to improve a consumer’s credit history or rating or to obtain an extension of consumer credit for a consumer.¹⁷⁴ The statute does not limit the fees a CSO can charge for these services.¹⁷⁵

The purpose of this CSO statute was to protect consumers from fraud when they employ credit repair organizations to fix distressed credit.¹⁷⁶ The language of the statute defining the organizations that repair credit, however, is very broad, including in the definition of a CSO a person who obtains an extension of consumer credit by another for the consumer.¹⁷⁷ The Attorney General of Texas¹⁷⁸ and the Fifth Circuit¹⁷⁹ have both opined that lenders who act as CSOs are not bound by state usury limits on loan fees.

EZCORP’s Annual Report summarizes how EZCORP generates fees as a credit service organization:

In our Texas stores, we do not offer signature loan or auto title loan products themselves, but offer fee-based credit services to customers seeking loans. In these locations, we act as a credit services organization (or “CSO”) on behalf of customers in accordance with applicable state laws, and offer advice and

¹⁷² *DoD Shares Loan Blame*, AIR FORCE TIMES, at 4 (Apr. 26, 2010) (“But blame the Pentagon, as well, for undermining Congress’ intent by limiting the law’s protections to just three types of closed-ended loans: payday loans, vehicle title loans and refund anticipation loans. These ‘advances,’ on the other hand, qualify as ‘open-ended lines of credit,’ a definition that allows the banks to completely ignore the law’s 36 percent interest rate cap.”).

¹⁷³ TEX. FIN. CODE ANN. § 342.201 (Vernon 2009).

¹⁷⁴ *Id.* § 393.001

¹⁷⁵ *Id.* § 393.001 *et seq.*

¹⁷⁶ Letter from Kymberly K. Oltrogge, Ass’t. Att’y Gen., to Hon. Mark W. Stiles, Chair of Calendars Comm. (Mar. 24, 1994), available at <http://ww.oag.state.tx.us/opinions/lo48morales/lo94-029.txt>. See also Eugene J. Kelley, Jr. et al., *The Credit Repair Organization Act: The “Next Big Thing?”*, 57 CON. FIN. L.Q. 49 (2003) (reporting that states enacted CSOs to regulate entities that attempt to improve a consumer’s credit rating)

¹⁷⁷ TEX. FIN. CODE ANN. § 393.001(3).

¹⁷⁸ Letter from Barry R. McBee, First Ass’t. Att’y Gen., to Leslie Pettijohn, Comm’r, Office of the Consumer Credit Comm. (Jan. 12, 2006).

¹⁷⁹ *Lovick v. Ritemoney, Ltd.*, 378 F.3d 433 (5th Cir. 2004).

assistance to customers in obtaining loans from unaffiliated lenders. Our services include arranging loans with independent third-party lenders, assisting in the preparation of loan applications and loan documents, and accepting loan payments for the lenders. We do not make, fund or participate in the loans made by the lenders, but we assist customers in obtaining credit and enhance their creditworthiness by issuing a letter of credit to guarantee the customer's payment obligations to the independent third-party lender.¹⁸⁰

The Texas legislature recently changed CSO law to specifically address title lenders and payday lenders who operate as CSOs,¹⁸¹ but the CSO model of operation remains significant because it is spreading to other states, such as Ohio.¹⁸² Payday lending consultants have even developed training material that lenders can purchase to teach them how to operate as a credit service organization.¹⁸³ Two-thirds of states have a credit service organization statute, and most have expansive definitions of "consumer service organization,"¹⁸⁴ so this loophole has the potential to allow lenders to avoid regulation that would otherwise ban the loan in a variety of states.

3. Higher Loan Amounts

A final way title lenders have avoided rate caps is by offering loans at amounts just above the rate cap. In California, small loans are capped at 2.5%, but loans over \$2,500 are not covered

¹⁸⁰ EZCORP, Inc., *supra* note xx, at 6. See also Mary Spector, *Taming the Beast: Payday Loans, Regulatory Efforts, and Unintended Consequences*, 57 DEPAUL L. REV. 961, 983-95 (2008).

¹⁸¹ Texas's HB 2592 requires payday and title lenders to make certain disclosures, and Texas's HB 2594 requires payday and title lenders to be licensed by the state.

¹⁸² Sheryl Harris, *Payday Lenders Find Legal Loophole*, PLAIN DEALER (Cleveland, OH), Apr. 18, 2010 at D1 ("Using the creativity they've displayed in other states that have tried to rout predatory lending, at least eight payday lenders have become licensed as 'credit services organizations,' which allows them to charge even more for hooking customers up with loans. That's outrageous. Credit service organizations are supposed to be groups - like Consumer Credit Counseling Service - that help consumers climb out of debt.").

¹⁸³ See Trihouse Enterprises, Inc., CSO Credit Services Organization, <http://www.paydayandpaycheckloans.com/texas-cso.html> (last visited July 26, 2010) ("Since [2005], payday loan operators in several other states in addition to Texas are beginning to realize the benefits to using the Credit Services Organization Model. These include South Carolina, California, Wisconsin, Colorado, Oregon, Oklahoma, New Mexico and more. . . . Thirty-one states plus Canada have provisions for the CSO Credit Services Organization entity. . . . For a thorough discussion of the CSO Credit Services Organization Model including the applicable Texas Statutes and the CSO Registration Form for Texas, we invite you to purchase our CSO Report.").

¹⁸⁴ Spector, *supra* note xx, at 985 n.174 (collecting statutes)..

by the cap.¹⁸⁵ Thus, title lenders offer loans for \$2,501 at any rate they agree on with the borrower.¹⁸⁶

One predictable effect of avoiding the rate cap by offering higher loan amounts is that more loans are undersecured. Given that in other states lenders' loan averages are less than \$1,000, setting \$2,500 as a minimum loan amount either drives many customers out of the title lending market or drives lenders to offer higher percentages of the value of the vehicle, which in turn likely leads to more lenders seeking deficiency judgments from borrowers who default. California offers an example of lawmakers choosing a side in the debate of whether consumers are better off with higher loan amounts, even if they did so unintentionally.

C. Authorized but Effectively Unregulated

In several states, title lenders do not operate with legal uncertainty from obviating usury laws and they do not operate under the weight of significant regulation because the states explicitly authorize title lending without any significant regulation. For instance, Arizona has a statute that authorizes title lending by recognizing the different forms the loan can take as legal transactions.¹⁸⁷ The only specific regulation of these loans, however, is a relatively high limit on the monthly interest rates lenders may charge borrowers, ranging from 17% per month (which is around 205% annually) for loans under \$500 to 10% per month (which is 120% annually) for

¹⁸⁵ CAL FIN CODE § 22303 (2009).

¹⁸⁶ Fast Auto and Payday Loans, Inc., Fast Auto and Payday Loans, Inc. Is Helping People Just Like You Get the Extra Cash You Need, <http://www.clacal.com/> (last visited July 26, 2010) (“Need a California title loan? \$2,501 to \$10,000 Available Now!”). Similarly, in Illinois, title lenders began offering 61-day loans when the legislature attempted to regulate title loans by passing a statute covering loans under 60 days. Franklin, *supra* note xx.

¹⁸⁷ The definition of “secondary motor vehicle finance transaction” which the statute governs reveals the statute regulates title lending because it defines the term to mean both traditional title lending and the sale-leaseback agreements some lenders employ:

“Secondary motor vehicle finance transaction”

(a) Means any contract that includes provisions for either:

(i) Obtaining a security interest in or lien on a motor vehicle other than in connection with the sale of that motor vehicle.

(ii) The sale or conditional sale of a motor vehicle and the seller's right to retain use of the motor vehicle after the sale or conditional sale.

(b) Includes any conditional sales contract or contract for the bailment or leasing of a motor vehicle in which the bailee or lessee agrees to pay for use of the motor vehicle and the bailee or lessee is required to become or has the option of becoming the owner of the vehicle for any or no compensation.

ARIZ. REV. STAT. § 44-281(13) (2010).

loans over \$5,000.¹⁸⁸ Otherwise, the Uniform Commercial Code governs these loans as secured transactions.¹⁸⁹

Other states authorize title lending in a slightly less direct form by simply authorizing small loans, which capture almost all title loans, but like Arizona they do not place any restriction on the interest rate for these loans. New Mexico, as an example, authorizes small-dollar loans through a specific statute,¹⁹⁰ and even makes it a violation of the small-loan statute to charge a usurious rate based on other state law.¹⁹¹ However, the small-loan statute does not have a usury cap,¹⁹² and the state does not have a general usury cap.¹⁹³ Like Arizona, the only provisions governing title loans are the generic ones in the Uniform Commercial Code.

D. Regulated as a Pawn Transaction

Some states regulate title loans as pawn transactions, affording title borrowers the same rights as pawn customers. But, determining whether a state's pawn brokering laws apply to title lending is sometimes difficult. Some states specifically include title lending under pawn laws. The Georgia legislature specifically defines "pledged goods," the item covered by the pawn law, as including automobile certificates of title: "'Pledged goods' means tangible personal property, including, without limitation, all types of motor vehicles or any motor vehicle certificate of title, which property is purchased by, deposited with, or otherwise actually delivered into the possession of a pawnbroker in connection with a pawn transaction."¹⁹⁴ On the opposite end of the spectrum, Maine specifically states that title lending is not within the pawn broking statute. The items covered by Maine's pawn law include "motor vehicles, but do[] not include documents evidencing title to motor vehicles."¹⁹⁵

¹⁸⁸ *Id.* § 44-291(G).

¹⁸⁹ Unif. Comm. Code Article 9.

¹⁹⁰ N.M. STAT. ANN. § 58-15-1 et seq. (2010).

¹⁹¹ *Id.* § 58-15-23.

¹⁹² *See id.* §§ 58-15-1–58-15-39.

¹⁹³ Section § 56-8-3 sets out that interest rates, "in the absence of a written contract fixing a different rate, shall be not more than fifteen percent annually," but it does not restrict the rate of interest if the parties agree in a written contract. In a similar context, the New Mexico Supreme Court has held a statute like this one does not cap interest rates. *See Superior Concrete Pumping v. David Montoya Constr.*, 773 P.2d 346 (N.M. 1989) (holding that the default interest rate set out in New Mexico's statute governing the unpaid balance of an open account was not a cap on interest rates if the parties agreed on a higher rate).

¹⁹⁴ O.C.G.A. § 44-12-130(5) (2010).

¹⁹⁵ ME. REV. STAT. 30-A M.R.S. § 3960(3) (2009). Thus, title loans are not exempt from Maine's usury statute, *id.* 9A-A.M.R.S. § 2-401, despite the fact that pawn transactions avoid the rate cap. *Id.* 30-A M.R.S. § 3963(1).

In the middle lie states where the statute itself does not make it clear whether title loans come within the definition of pawn transactions. In Alabama, for instance, it does not appear that title loans fall within the definition of pawn transactions because title lenders do not retain possession of the vehicles and the statute defines a pawn transaction as “[a]ny loan on the security of pledged goods or any purchase of pledged goods on condition that the pledged goods are left with the pawnbroker and may be redeemed or repurchased by the seller for a fixed price within a fixed period of time.”¹⁹⁶ But, the Alabama Supreme Court has held that title lenders holding the certificate of title counts as “the pledged good” that the lender holds, making title loans subject to pawn transaction rules.¹⁹⁷

The courts have provided certainty that Alabama’s pawn laws apply to title lenders, but other states have similarly vague definitions of pawned goods, and courts have not stepped in to clarify the law. For instance, in Alaska, the interest rate on small loans is capped,¹⁹⁸ but the statute with the cap states it “does not apply to individual loans by pawnbrokers or loan shops where separate and individual loans do not exceed \$500.”¹⁹⁹ It is unclear if title loans, however, are pawn loans. This uncertainty can result in courts finding title lenders are violating usury statutes if the lender guesses incorrectly that title loans are governed by pawnshop laws.²⁰⁰

When title loans are governed by pawn laws, a series of common provisions usually apply:²⁰¹ the law forbids lenders from seeking deficiencies and does not require them to pay surpluses;²⁰² loan terms are set at 30 days;²⁰³ interest rates are sometimes capped but the cap is

¹⁹⁶ ALA. CODE § 5-19A-2(3) (2010).

¹⁹⁷ *Floyd v. Title Exch. & Pawn, Inc.*, 620 So. 2d 576, 579 (Ala. 1993).

¹⁹⁸ ALASKA STAT. § 06.20.230 (2010).

¹⁹⁹ *Id.* § 06.20.330(b).

²⁰⁰ In *Chandler v. Kentucky Title Loan, Inc.*, 16 S.W.3d 312 (Ky. Ct. App. 1999), the court found a title lender was not a pawnbroker under Kentucky law because “we find a significant difference between the Kentucky and Alabama statutes with respect to the breadth of the definition of a pawn transaction.” *Id.* at 314. Because it was not a pawn transaction, “it was not exempt from application of KRS Chapter 288 and it operated its business in violation of [the statute].” *Id.* at 315.

²⁰¹ Carrie Teegardin, *Title Loan’s Price High*, THE ATLANTA JOURNAL-CONSTITUTION, Jan. 25, 2009 (“The fact that the transaction is technically a pawn means the money comes with the same risks and benefits of taking a diamond ring or stereo to a pawnshop. The lender is able to keep the entire proceeds from a repossession sale, including the amount which exceeds the loan.”).

²⁰² CODE OF ALA. § 5-19A-6 (2010).

²⁰³ *E.g.*, O.C.G.A. § 44-12-131(a)(1).

set at a high amount;²⁰⁴ and lenders must wait for a set period after default before they sell the collateral.²⁰⁵

In addition to these common pawn law provisions, Georgia has added a series of provisions specifically directed at auto title loans that do not apply to other pawn transactions.²⁰⁶ These laws appear to supplement the standard pawn statute with provisions that are important to regulating transactions where the debtor retains possession of the collateral. For instance, Georgia prohibits sale–lease–back agreements,²⁰⁷ transactions that only arise if the debtor retains possession of the collateral (since possession is the major right granted in leasing a good). Additionally, Georgia’s statute gives lenders the right to take possession of vehicles upon default without judicial approval if the lender can do so “without breach of the peace.”²⁰⁸ Finally, the statute outlines the charges a lender can levy if it takes possession of vehicle²⁰⁹ and requires lenders disclose these charges to borrowers.²¹⁰ Because it specifically regulates title loans through these provisions, Georgia might also fit within the next categories of laws—laws that directly and extensively regulate title loans.

E. Regulated Directly and Extensively (Although not Necessarily Strictly)

Numerous states have laws that were specifically created to address title lending. This section outlines some of the common features of these laws, although individual states may only have some of these requirements. In addition, this section is not meant to be an exhaustive exploration of every provision of every state statute; instead, it attempts to highlight the provisions that are most controversial and most important.

²⁰⁴ CODE OF ALA. § 5-19A-7(a) (2010) (setting a 25% per month interest rate cap); O.C.G.A. § 44-12-131(a)(4)(A) (same).

²⁰⁵ CODE OF ALA. § 5-19A-5(c) (2010) (“All goods purchased by the pawnbroker except for automobiles, trucks, and similar vehicles shall be maintained on the premises by the pawnbroker for at least fifteen business days before the goods may be offered for resale. Automobiles, trucks, and similar vehicles shall be maintained on the premises for 21 calendar days.”); *id.* 5-19A-4(1) (“(1) The statement that “Any personal property pledged to a pawnbroker within this state is subject to sale or disposal when there has been no payment made on the account for a period of 30 days past maturity date of the original contract, and no further notice is necessary.”); *id.* §5-19A-10(b) (“Pledged goods not redeemed on or before the maturity date if fixed and set out in the pawn ticket issued in connection with any transaction shall be held by the pawnbroker for 30 days following that date and may be redeemed or repurchased by the pledgor or seller within the period by the payment of the originally agreed redemption price, and by the payment of an additional pawnshop charge equal to the original pawnshop charge.”).

²⁰⁶ Similarly, Minnesota governs title loans with its pawn laws supplemented by some additional title loan specific provisions. *See* MINN. STAT. § 325J.095 (2009) (listing provisions applying only to title loans).

²⁰⁷ O.C.G.A. § 44-12-131(a)(2).

²⁰⁸ *Id.* § 44-12-131(a)(3).

²⁰⁹ *Id.* § 44-12-131(a)(4)(C).

²¹⁰ *Id.* § 44-12-138(3),(12)-(15).

1. Licensing Requirements

A primary form of direct regulation of title lenders is licensing requirements.²¹¹ Tennessee's law, for instance, voids any title loan made by an entity that is not licensed by the state.²¹² To obtain a license, a title lender must, among other requirements, (1) have net assets of \$75,000 per location,²¹³ (2) pay an \$800 filing fee per location,²¹⁴ (2) submit a balance sheet and income statement prepared by an unaffiliated certified public accountant,²¹⁵ and (3) obtain a surety bond of \$25,000 per location (not to exceed \$200,000 per firm).²¹⁶ In addition to requirements for obtaining a license, firms must report certain information to the state²¹⁷ and make their records available for examination.²¹⁸

2. Rollovers

Many states directly regulating title loans have laws addressing the issue of rollovers. Tennessee addresses rollovers by requiring that, after three rollovers, the lenders must begin reducing the principal owed on the loan.²¹⁹ Other states specifically limit the number of times a customer can rollover a title loan.

Some laws limiting rollovers likely have no real effect on the business practices of lenders. In Delaware, for instance, rollovers that extend a loan for more than 180 days are formally prohibited.²²⁰ This restriction, however, does not prevent borrowers from paying off a title loan after 180 days and then immediately taking out a new title loan from the same lender because "rollover" under the statute "means the extension of an outstanding and unpaid indebtedness beyond the originally stated repayment period."²²¹

3. Repossessions

²¹¹ *E.g.*, IDAHO CODE § 28-46-503 (2010); 5 DEL. C. § 2202 (2010); FLA. STAT. § 537.007 (2010).

²¹² TENN. CODE ANN. § 45-15-105 (2010).

²¹³ *Id.* § 45-15-106(a)(1).

²¹⁴ *Id.* § 45-15-106(d)(1).

²¹⁵ *Id.* § 45-15-106(d)(2).

²¹⁶ *Id.* § 45-15-106(d)(3).

²¹⁷ *Id.* § 45-15-109.

²¹⁸ *Id.* § 45-15-108.

²¹⁹ TENN. C.A. § 45-15-113(d).

²²⁰ 5 DEL. C. § 2254.

²²¹ 5 DEL. C. § 2250(3). For an analysis of this same issue in the payday loan context, see Ronald J. Mann & Jim Hawkins, *Just Until Payday*, 54 UCLA L. REV. 855, 897-98 (2007).

States regulating title loans directly often provide rules for lenders attempting to gain possession of vehicles if the borrower defaults. Like Georgia,²²² most states incorporate²²³ or at least do not displace²²⁴—Article 9’s requirement that secured lenders do not breach the peace while gaining possession of a vehicle.²²⁵ Illinois goes a few steps further, requiring that lenders notify borrowers of their intention to take possession and mandating that lenders afford “the obligor the opportunity to make the vehicle available to the lender at a place, date and time reasonably convenient to the lender and obligor” and permit the borrower “to remove any personal belongings from the vehicle without charge or additional cost.”²²⁶ Other states disallow lenders to purchase vehicles they have repossessed,²²⁷ despite the normal rule in secured transactions which permits lenders to purchase goods they have repossessed subject to some restrictions.²²⁸

4. *Deficiencies and Surpluses*

Most states that directly regulate title loans require lenders to pay any surpluses generated by sales of repossessed vehicles and prohibit lenders from seeking anything from borrowers beyond taking possession of the vehicle.²²⁹ Delaware’s statute provides a typical example of how the law is formulated:

Notwithstanding any other provision of law, the proceeds of a licensee's sale of a motor vehicle that is used as security for a title loan shall satisfy all outstanding and unpaid indebtedness under that loan, and the borrower on that loan shall not be liable for any deficiency resulting from that sale. The licensee shall nevertheless still be required to pay the borrower any surplus arising from the sale

²²² See *supra* note xx and accompanying text.

²²³ IDAHO CODE § 28-46-507(2) (2010) (“If the debtor does not cure the default within the ten (10) days, the title lender may proceed to exercise its rights under chapter 9, title 28, Idaho Code.”); 5 DEL. C. § 2259 (2010) (“A licensee may take possession of the motor vehicle that is used as security for a title loan only in accordance with procedures specified in part 6 (Default) of Article 9 (Uniform Commercial Code -- Secured Transactions) of Title 6.”); 38 ILL. ADM. CODE 110.140 (2010) (same).

²²⁴ NEV. REV. STAT. ANN. § 604A.455(1) (2010).

²²⁵ Unif. Comm. Code § 9-609(b)(2).

²²⁶ 38 ILL. ADM. CODE § 110.390(B) (2010).

²²⁷ IDAHO CODE § 28-46-508(6).

²²⁸ Unif. Comm. Code § 9-610(c).

²²⁹ *E.g.*, IDAHO CODE § 28-46-508(2); TENN. CODE ANN. § 45-15-115 (2) (2010); MISS. CODE ANN. § 75-67-411 (1) & (5); MONT. CODE ANN., § 31-1-816(2)(i) (2010); NEV. REV. STAT. ANN. § 604A.455(1) (2010); S.C. CODE ANN. § 37-3-413(5) (2009); Utah Code Ann. § 7-24-204 (2010).

of that motor vehicle as required by part 6 (Default) of Article 9 (Uniform Commercial Code -- Secured Transactions) of Title 6.²³⁰

While some states permit lenders to seek payment if the borrower purposefully prevents the lender from repossessing the vehicle or damages the vehicle,²³¹ some states like Delaware even prevent personal liability in these cases.

5. Restrictions on Loan Amounts

Some states restrict the amount of money title lenders can lend to borrowers, but different states use different measuring sticks to set the loan amount cap. The simplest caps are fixed dollar amounts, usually \$2,500, that apply to all title loans regardless of the vehicle serving as collateral, the borrower, or the purpose of the loan.²³² Other states cap the loans based on the value of the vehicle, sometimes providing appraisal guides as a measuring tool.²³³ South Carolina's statute provides one example:

A lender may not make a short-term vehicle secured loan in a principal amount greater than the fair market retail value of the motor vehicle securing the loan, as determined by common industry appraisal guides. If the motor vehicle securing the loan is not listed in common appraisal guides, the lender shall use his best judgment to determine the value.²³⁴

Finally, and perhaps of greatest interest, some states require that title lenders base the amount of the loan on the borrower's ability to repay the loan. Several states have general language that requires lenders to assess "the ability of the customer seeking the title loan to repay the title loan, including the customer's current and expected income, obligations and employment."²³⁵ Some statutes make clear that determining the consumer's ability to repay the

²³⁰ 5 DEL. C. § 2260 (2010).

²³¹ IDAHO CODE § 28-46-508(2) (forbidding lenders from seeking payment for deficiencies except in cases "where the debtor prevented repossession of the vehicle, damaged or committed or permitted waste on the vehicle or committed fraud").

²³² *See, e.g.*, MISS. CODE ANN. § 75-67-415(f) (2010) (forbidding title loans over \$2,500); TENN. CODE ANN. § 45-15-115 (3) (2010) (same); 38 ILL. ADM. CODE 110.370(a) (2010) (stating title loans cannot exceed \$4,000); R.S. MO. § 367.527(2) (2010) (prohibiting title loans over \$5,000).

²³³ *See, e.g.*, UTAH CODE ANN. § 7-24-202(c) (2010) (stating title lenders may not "extend a title loan that exceeds the fair market value of the vehicle securing the title loan"); IDAHO CODE § 28-46-508 (3); NEV. REV. STAT. ANN. § 604A.450(1) (2010).

²³⁴ S.C. CODE ANN. § 37-3-413(4) (2009).

²³⁵ NEV. REV. STAT. ANN. § 604A.450(2) (2010). *See also* ORS § 725.605 (2010) ("A lender may not make a title loan to a consumer without forming a good faith belief that the consumer has the ability to repay the title loan."); UTAH CODE ANN. § 7-24-202(3)(d) ("[A lender] may not extend a title loan without regard to the ability of the person seeking the title loan to repay the title loan, including the person's: (i) current and expected income; (ii) current obligations; and (iii) employment."); S.C. CODE ANN. § 37-3-413(3) (2009) ("Before making a short-

loan does not require a formal credit check but can instead rely on the consumer's reported income and obligations.²³⁶ Illinois is more simplistic and easy to apply, prohibiting any loans that have a single payment that "exceeds 50% of the obligor's gross monthly income."²³⁷

6. Restrictions on Fees

Many states that directly regulate title lending set limits on the interest rates and other fees that lenders can charge.²³⁸ These interest rate caps vary from 18%²³⁹ or 30% per year²⁴⁰ to around 206% a year²⁴¹ or 304% a year.²⁴² In addition to limits on interest rates, some statutes limit the amount lenders can charge for noninterest rate charges, such as the fees for dishonored checks²⁴³ and the cost of recording a lien.²⁴⁴

As this section illustrates, states have taken a variety of approaches even within the framework of directly regulate title lending. In many states, the law is in flux or uncertain; the next Part aims to offer guidance to states that are considering changes in their approach.

III. EVALUATING TITLE LENDING LAWS

In light of the different regulatory models discussed in Part II, this Part argues that the best approach to regulating title lending is to enact laws or regulations aimed specifically at title loan transactions. I begin by assessing the case for banning title lending, concluding that while arguments based on cost may compel some to accept a ban, the case is difficult to make. On the

term vehicle secured loan, a lender shall form a good faith belief that the borrower has the ability to repay the loan, considering the borrower's, and any co-borrower's, employment, monthly income, and other monthly expenses compared to the loan's repayment obligation for the original term and permitted renewals.").

²³⁶ See UTAH CODE ANN. § 7-24-202(4) ("A title lender has met the requirements of Subsection (3)(d) if the person seeking a title loan provides the title lender with a signed acknowledgment that: (a) the person has provided the title lender with true and correct information concerning the person's income, obligations, and employment; and (b) the person has the ability to repay the title loan."); S.C. CODE ANN. § 37-3-413(3) (2009) ("The lender is considered to comply with this subsection if the lender obtains from the borrower, on a form separate from the loan agreement, a signed statement that the information the borrower has provided regarding employment, income, and expenses is true and correct and that, given the information, the borrower believes he has the ability to repay the loan.").

²³⁷ 38 ILL. ADM. CODE §110.340(a) (2010).

²³⁸ Of course, some states, like Delaware, have no interest rate limits. See 5 DEL. C. § 2250-61.

²³⁹ 9 VT. STAT. ANN. § 41a.

²⁴⁰ FLA. STAT. § 537.011(1) (2010).

²⁴¹ ARIZ. REV. STAT. § 44-291.

²⁴² MISS. CODE ANN. § 75-67-413.

²⁴³ ORS § 725.615(2)(a) (2010) (limiting fees for dishonored checks to \$20).

²⁴⁴ MONT. CODE ANN. § 31-1-817(2) (2010) (limiting charges for recording a lien to the actual costs to the lender).

other end of the spectrum, states that authorize title lending without any restrictions or regulate title lending as pawn transactions offer too little regulation to ensure meaningful protections for customers. The final section of this Part makes the case for industry-specific regulation and suggests laws that are important for policy makers to enforce to ensure a fair marketplace.

A. The Argument for Banning Title Loans

Bans or effective bans on title lending are a popular regulatory choice, but the justifications for these bans are not entirely clear. Based on the data in Part I, we know title lending borrowers experience a relatively low rate of having their vehicles repossessed, and we have no evidence that most of those who lose a vehicle have lost their own means of transportation. Moreover, in eliminating title loans, bans may undermine the useful functions title loans can have in funding small businesses or helping borrowers with emergency needs. In light of the weaknesses in the most common arguments for a ban, the best argument opponents have for drastic intervention into title lending markets is the high cost of the loans.

1. Title Lending's Spurious Connection to Financial Distress

The case for banning title lending would be strong if proponents of bans could demonstrate the negative externalities title lending generates by pushing borrowers into financial distress. In the states for which we have repossession rates, however, the vast majority of borrowers do not lose their vehicles, ranging from over 99% of borrowers retaining their cars to, in only one year, around 87%.²⁴⁵ Of those who do lose their vehicle, many do not lose a functioning mode of transportation,²⁴⁶ so it is not clear title lending is the real cause of the loss. Most importantly, there is little evidence of how many people lose the only vehicle in their household.

For those who do lose their vehicle to repossession, we know that many lose the equity they have in the vehicle because lenders can charge the costs of repossessing, storing, and selling them. But, in terms of absolute dollars, the losses are likely small because the average value of the collateral, and thus the possible equity the borrower has, is small.²⁴⁷ And, this same problem of borrowers losing equity exists under Article 9 of the Uniform Commercial Code because it also permits lenders to charge costs against the borrower, so the argument against title lending just based on losses from repossession fees proves too much. At the very least, policymakers who have relied on repossession rates and fears of people losing their only vehicle based on reports by academics need to reconsider these positions in light of the new reports state

²⁴⁵ See *supra* Table 2.

²⁴⁶ See note xx.

²⁴⁷ See Part I.B.2.a.

regulators are generating and the fact no studies have demonstrated people are losing access to their only way to work.

2. Bans Prevent Beneficial Uses of Title Loans

Bans are blunt instruments that eliminate beneficial uses of title lending along with harmful uses. Based on my small survey and the surveys by a major title lender and the FDIC, some borrowers are using title loans to meet short-term emergency liquidity crises, and others use title loans to finance small business operations. While it is true that some borrowers are simply delaying financial breakdown by using title loans for ordinary expenses, a ban also eliminates the loans for those customers using the product rationally.

If borrowers cannot use title loans, some commentary suggests they will turn to other inferior forms of credit or be denied access to credit altogether.²⁴⁸ The title lender's survey of its customers seems to substantiate this view, as shown in Table 4.

Table 4: Borrowers' Alternatives to Title Loan

Alternative	Number Selecting	Percentage of Customers Selecting
None	774	71.93%
Credit Unions	93	8.64%
Bank Loan	154	14.31%
Credit card cash advance	94	8.73%
Bounced Check	39	3.62%
Pay Late Fee	189	17.57%
Borrowed Money from Relatives/Friends	67	6.23%
Payday Loan	8	0.74%
Sell car	2	0.19%

Among the customers we surveyed in Houston, however, the majority of people said they would just do without if they did not have access to title loans.²⁴⁹ Table 5 summarizes the results.

Table 5: What Houston Customers Would Do Without Title Loans

Alternative	Number Selecting	Percentage of Customers Selecting
Get a loan elsewhere	11	31.43%

²⁴⁸ Zywicki, *supra* note xx, at (“If deprived access to title loans, many consumers would substitute to less-preferred sources of credit or lose access to legal credit altogether.”).

²⁴⁹ If nothing else, the different results from the title lender's survey and my survey highlight the importance of what choices the survey instrument gives respondents, and I suggest future surveys always include “choose not to borrow” as an option for a question about alternatives to title lending.

Sell car	3	8.57%
Not borrow and do without loan	18	51.43%
No answer	3	8.57%

If these results were shown by later research to be representative of title lending customers, it suggests that for many customers, title lending is not an essential source of credit that will necessarily be replaced by an inferior choice. If this is true, then title lending is a very expensive form of optional credit. More research is needed to attempt to assess what borrowers would do if states permitting title lending banned it.

At the very least, any ban on title lending should recognize the useful social function title lending can play for small businesses and exempt businesses from the ban. Existing state and federal statutes can serve as examples of how to only restrict consumer uses of title loans. The Fair Debt Collection Practices Act, for instance, only applies to consumer debt.²⁵⁰ The purpose of the debt is set at the time the transaction begins, and debt collectors are not bound by the Act's rules if they are collecting business debt.²⁵¹ Even if supporters of a ban are concerned about non-productive consumer uses for title loans, a ban on title loans could similarly look to the borrower's purpose in taking out the loan and exempt business purposes from the ban or rate cap.

3. Price: The Best Case for Bans

Several of the most powerful critiques of title lending are merely different ways of saying the simple argument that title loans are too expensive. For example, the argument that people rollover their loans repeatedly, paying only the interest fee, exhibits concern about the ultimate price of title loans. The critique of the structure of title loans as single lump sum payments really reflects a concern over the price borrowers pay for the loan because the lump sum often requires multiple payments of fees.

Because the high cost of title loans is well established, for those who are inclined to regulate the cost of services to lower-income Americans, price is a powerful justification for banning title lending. It does not appear an inexpensive form of this transaction is possible for the clientele currently served by title lenders, so banning is the only option to deal with this

²⁵⁰ See 15 USCS § 1692a(5) (“The term ‘debt’ means any obligation or alleged obligation of a consumer to pay money arising out of a transaction in which the money, property, insurance, or services which are the subject of the transaction are primarily for personal, family, or household purposes, whether or not such obligation has been reduced to judgment.”). Similarly, Texas’s Deceptive Trade Practices Act defines “consumers” under the Act and exempts large businesses. See TEX. BUS. & COM. CODE § 17.45(4) (“‘Consumer’ means an individual, partnership, corporation, this state, or a subdivision or agency of this state who seeks or acquires by purchase or lease, any goods or services, except that the term does not include a business consumer that has assets of \$ 25 million or more, or that is owned or controlled by a corporation or entity with assets of \$ 25 million or more.”).

²⁵¹ *Miller v. McCalla, Raymer, Padrick, Cobb, Nichols, & Clark, L.L.C.*, 214 F.3d 872, 874-75 (7th Cir. 2000).

pricey product if the aim is to eliminate the cost. Especially for those regulators and academics who are sanguine about interference with personal decision making, price seems to be the best justification for banning title lending.

B. Title-Lending Specific Laws v. Pawn Laws and Regulatory Uncertainty

Several states allow title lenders to operate by structuring the products to avoid usury limits or by squeezing into laws aimed at regulating other products like pawn transactions, credit cards, or credit service organizations. These schemes present two problems for protecting consumers. First, for states where lenders are not clearly sanctioned, the legal uncertainty prevents a fully competitive marketplace. Second, because the laws lenders operate under are not tailored to the title lending transaction, they leave customers vulnerable to harms.

1. Uncertainty

When title lenders operate in states without explicit authorization, it creates uncertainty for these businesses because at any time a court may find a lender has violated the usury statute. Some states, such as Texas, have clearly indicated that title lenders can operate through laws not specifically tailored for them,²⁵² and in those states, firms operate with confidence.²⁵³

In states without a court holding lenders can operate through other laws, however, the uncertainty is a barrier to entering the market to compete. For instance, until Virginia recently specifically authorized title lending (after years of lending by title lenders through an open-ended credit statute), TitleMax refused to operate in the state. When the law changed, TitleMax began offering loans in Virginia.²⁵⁴ One consumer advocate in Virginia so believed in the power of uncertainty that he said keeping the law uncertain was the best strategy in the fight against title lenders.²⁵⁵

Stock prices can reflect the deleterious effect of uncertainty on alternative financial service providers. Gary Rosin describes the effects uncertainty had on the stock of Advance America, a large payday lender, when multiple bills in Congress and numerous states had been

²⁵² *Lovick v. Ritemoney Ltd.*, 378 F.3d 433, 442, 444 (5th Cir. 2004).

²⁵³ See Don Baylor, *Loopholes Allow Loan Sharks to Prey on Hardworking Texans*, SAN ANTONIO EXPRESS-NEWS, Feb. 16, 2007, at 9B (“Payday lending is big business in Texas. In 2003, workers took out 1.8 million payday loans.”).

²⁵⁴ See TMX Finance LLC, Form S-4 (Dec. 31, 2010), at F9 (“On April 11, 2010, the state of Virginia passed a new law, the Virginia Motor Vehicle Title Loan, that eliminates the extension of credit under the Open-End Credit product and regulates a simple interest secured loan up to 12 months in term. The legislation requires all locations to be licensed through the Virginia Bureau of Financial Institutions. This new law includes a cap on interest rates, but the cap is higher than the rates currently charged by the Company. This new law became effective October 1, 2010 and allows the Company to expand in this state with a product that is now regulated by the Commissioner.”).

²⁵⁵ Speer webinar, *supra* note xx.

introduced that would affect its business: “Advance America had earned \$30 million in profits in the second half of 2008, and then booked another \$26 million in profits in the first quarter of 2009, yet its stock was down by more than 75 percent from its high because of uncertainty about the payday loan.”²⁵⁶ It is likely this sort of uncertainty stymies growth.

In addition to fewer firms offering loans in these states because of disincentives, it is possible that the companies offering loans in these states are those with the least to lose—ones that are thinly capitalized and essentially judgment proof. TitleMax’s refusal to operate in Virginia is instructive: As a large lender with substantial assets, it is subject to suits if it, for instance, wrongfully repossesses and sells a borrower’s vehicle. Thus, because uncertainty decreases the number of companies willing to do business and may result in lower quality companies operating, states should enact title-loan specific laws.

2. States Without Title Lending Laws Do Not Adequately Protect Consumers

When a state does not have a law governing title loans, Article 9 of the Uniform Commercial Code applies to title loans as secured transactions, empowering lenders to sue borrowers for deficiency judgments. As Part I.A.2.b. argued, this ability to seek deficiencies likely only affects the borrowers with the least valuable vehicles because these vehicles will not have sufficient equity in them to cover the costs of repossession and resale. Because it fails to protect the customers who are likely to be the least advantaged from financial distress, Article 9 is not a good substitute for title-loan-specific laws.

A potentially powerful counterargument to my view is that lenders do not seek many deficiency judgments so this drawback is not significant. The legal power to do so, however, likely gives lenders leverage over borrowers who are afraid of being sued. Martin and Adams report that lenders in New Mexico routinely include the right to seek a deficiency in their loan agreements, suggesting that lenders believe this provision affects the borrower’s perception of the lender’s power. Even if a debtor is judgment-proof, the threat of a lawsuit may squeeze out additional payments.

Title lenders operating in states governed by pawn laws are not allowed to seek deficiencies, but they are also not required to return surpluses to borrowers. These laws fail to protect those borrowers with more expensive vehicles. Since some title loans are oversecured, as demonstrated by the \$251,047 lenders returned to borrowers in Tennessee in 2008,²⁵⁷ for instance, pawn law’s failure to require surplus payments fails to protect a specific segment of title lending customers. It is unlikely that title lenders would exit a state because of a requirement they return surpluses because some of the largest lenders already return surpluses

²⁵⁶ GARY RIVILIN, *BROKE, USA: FROM PAWNHOPS TO POVERTY, INC.—HOW THE WORKING POOR BECAME BIG BUSINESS* 313-14 (2010).

²⁵⁷ 2010 Tenn. Report at 8.

even though they are not required by law,²⁵⁸ and in a study of pawnbrokers, John Caskey found requiring pawnbrokers turn over the surplus did not affect number of pawnshops per million capita.²⁵⁹

C. Specific Features Legislators Should Consider

Instead of banning title lending or requiring lender to fit within existing credit laws, states should enact provisions specifically tailored to title lending. This section outlines tentative suggestions I make about what I believe are the most important features title loan laws should include. I argue that states should forbid lenders from seeking deficiencies, require lenders to provide surpluses, and require lenders to give disclosures aimed at overcoming overly optimistic assessments of rollovers and repossession rates and misunderstandings about the cost of the transaction. Also, it is important any title lending law provide for flexibility that permits lenders to develop the product. On the other hand, I argue that caps on loan amounts and loan interest rates are likely to produce negative consequences. Yet, because several critical questions remain unanswered, my suggestions are cautious.

1. Deficiencies and Surpluses

As I have argued, laws allowing deficiencies probably hurt the least advantaged title lending customers, so laws specifically aimed at title lending should account for this risk. Forbidding lenders from seeking deficiencies will likely also have the effect of emphasizing to lenders the importance of considering the customer's ability to repay to attempt to ensure that borrowers do not default, leaving the lender holding a loan for more than the value of the collateral. If lenders know they will not be able to obtain deficiencies or incentivize repayment with the threat of deficiencies, they should be more likely to make less risky loans. The negative consequence on limits on deficiencies is that lenders may offer lower loan amounts to ensure the equity in the vehicle will pay both the principal amount and the costs of repossession.

Requiring that lenders return any surplus from selling the vehicle mitigates the effect of smaller loans to some extent, so it is an important companion law (assuming UCC Article 9's provision to this effect is displaced by the title lending law). If lenders have to return surpluses, borrowers will at least be protected to the extent the equity exceeds the costs of repossession. As Part I.B.2 makes clear, however, this protection is still minimal, so borrowers will suffer in states forbidding deficiencies by getting lower loan amounts. However, on balance, the prohibition's protections probably outweigh the harms.

²⁵⁸ See Title Pawn Industry Warns Legislation Could Hurt the Poor, Access North Georgia, Oct. 25, 2005, at <http://new.accessnorthga.com/detail.php?n=136791&c=2> (reporting TitleMax returns surpluses to customers in Georgia even though the law does not require it).

²⁵⁹ See Prager, *supra* note xx, at 11 (discussing Caskey's study).

One legislator has express concern over the requirement that lenders return surpluses because lenders are not protected when vehicles are not worth anything after repossession.²⁶⁰ The losses a lender might face, however, are adequately accounted for in the high interest rate on these loans, so requiring surpluses is not necessary to balance lenders' losses.

2. Disclosures Aimed at Optimism and Cost

My limited survey found that the people we surveyed were overly optimistic about the risks they will rollover their loans multiple times and that they will lose their vehicle. More evidence is needed to conclusively establish these claims, but I tentatively recommend that states enact disclosure laws aimed at combating over optimism. Marianne Bertrand and Adair Morse have tested such disclosures in the context of payday lending rollovers and found that a disclosure informing payday lending customers about the average rollover rates "reduces the take-up of payday loans by about 11 percent in a 4 month-window following exposure to the new information."²⁶¹ Similar measures could be tested or adopted for title lending laws. Generally firms tolerate disclosure requirements well, so it is unlikely to substantially decrease the number of firms competing for business in a state.

Another tentative conclusion from my survey was that people did not understand the relative cost of title lending because only a quarter of the borrowers recognized that title loans were a lot more expensive than credit cards. Again, more research is required to understand generally how title loan customers understand the cost of the transaction, but since price is usually the most important term of a consumer contract and the price is so high for title loans, requiring clear disclosures seems appropriate.

The best disclosures would involve the cost of borrowing per \$100 borrowed placed on the windows of the store to foster price competition. Rules about stating loan cost as an APR should be vigorously enforced because lenders should be able to train staff to discuss APRs. Since most title loans are for one month terms, it should be easier for lenders to correctly calculate the APR on a loan than lenders offering payday loans where the length of the loan depends on the length of time until the borrower's next payday.²⁶² Since lenders appear to

²⁶⁰ Title Pawn Industry Warns Legislation Could Hurt the Poor, Access North Georgia, Oct. 25, 2005, at <http://new.accessnorthga.com/detail.php?n=136791&c=2> ("Rep. James Mills, R-Gainesville, the House banking chairman, said it's too early to say what the Legislature will do, but added he is having second thoughts about the bill he introduced requiring brokers to rebate any excess to consumers whose cars have been repossessed and sold. He said he's learned that many of the repossessed cars are junk which do not even cover the cost of the pawn. 'If you're going to make them give back the excess, what about the times the vehicle is not worth the loan?'").

²⁶¹ Marianne Bertrand & Adair Morse, Information Disclosure, Cognitive Biases and Payday Borrowing (unpublished manuscript) (July, 2010), available at <http://ssrn.com/abstract=1532213> at 1.

²⁶² See Mann & Hawkins, *supra* note xx, at 855, 904 ("Interest-rate disclosures are misleading because the amount of the fee charged generally does not depend on the number of days until the borrower's payday. An interest-rate disclosure would suggest that the rate changes every day depending on which day in the pay cycle the borrower

already compete for customers based on price,²⁶³ clear disclosures should be effective in optimizing competition in the market.

3. *Flexibility to Permit Innovation*

Some current title lending laws restrict title lending to its traditional month-long structure.²⁶⁴ In Texas, however, lenders have had the freedom to create innovative alternatives to the traditional title loan. While such innovations have the potential to harm consumers, in Texas it appears that the flexible CSO format has allowed some firms to develop a more consumer-friendly loan structure in which the title loan is a longer term loan that is amortizing. Unlike the traditional title loan which requires a lump sum payment after a short period, several companies in Texas offer loans that act much more like the ones envisioned by consumer advocates attempting to reform title lending.

Cash America, a large public company, has a product that exemplifies this approach. The company offers 12 to 24 month loans that are fully amortized and are explicitly based on the customer's credit score and ability to repay along with the value of the vehicle.²⁶⁵ The cost of Cash America's product is less than normal title loans, closer to 110% APR.²⁶⁶ The company's goal in creating this product was to reach a different demographic than title loans—customers who are closer to mainstream borrowers that want a product more closely resembling a traditional loan.²⁶⁷

Additionally, several smaller companies in Houston offer amortizing title loans with longer terms, but unlike Cash America, they do not do formal credit checks.²⁶⁸ Texas Title Loans, as one example, advertises:

obtains the loan, when actually the cost is uniform throughout that cycle. This confusion does nothing to help consumers evaluate competing products.”).

²⁶³ See *supra* notes xx – xx and accompanying text.

²⁶⁴ See, e.g., O.C.G.A. § 44-12-131 (limiting title loans to 30 day loans).

²⁶⁵ Vaugh & Bourns Interview, *supra* note xx.

²⁶⁶ *Id.*

²⁶⁷ *Id.*

²⁶⁸ The Loan Depot, Are You Trapped in a 30-Day Loan?, http://www.yourloandepot.com/blog_entries/ai/Corporate-5/are-you-trapped-in-a-30-day-loan.html (last visited Aug. 18, 2011) (“WE CAN GET YOU OUT OF A 30-DAY LOAN AND SET YOU UP ON A TERM LOAN AND GIVE YOU UP TO 12 MONTHS TO PAYOFF!!”); Advantage Finance, LLC, Frequently Asked Questions, <http://www.cartitleloanshouston.com/pages/faqs.html> (last visited Aug. 18, 2011) (“THESE ARE INSTALLMENT LOANS. Portions of your monthly payment goes to principal and a portion of it goes to interest. If you make your monthly installment payments every month when due, your loan will be paid off at the end of the contract term. THESE LOANS ARE NOT INTEREST ONLY LOANS. . . Depending on the loan amount, you can take up to 24 months to pay off the loan.”).

With our loans your contract length is 9 Months. . . . With our loans a portion of each monthly payment is applied to your principal. . . . With [our competitors'] loans you have no ending contract date. With their loans no portion of your monthly payment goes to your principal. With their loans the only way to pay your loan off in full YOU MUST PAY ENTIRE LOAN BALANCE IN ONE PAYMENT!²⁶⁹

Another lender, TJD Financial Services, offers amortizing loans specifically to keep people out of the trap created by large balloon payments.²⁷⁰ Finally, one other small operators in Houston offer customers the choice of a traditional title loan or an installment plan.²⁷¹

Ideally, a statute specifically governing title loans would be flexible enough to bring innovative approaches within its domain. This would encourage firms to compete by offering better loans to customers, and it would restrain firms from developing products that violate the provisions in a title-lending specific law that protect consumers from abuses.

4. Caps on Loan Amounts

Several states currently limit the amount that title lenders can give to customers either by setting an absolute dollar limit or limiting the loan to some portion of the value of the collateral, as low as half the value of the vehicle.²⁷²

Based on the data we have, I believe these caps on loan amounts are likely to have negative consequences for borrowers. The law should aim to incentivize lenders to loan the highest percentage of the vehicle possible because then borrowers who lose a vehicle will lose the least amount of the equity they have in the vehicle. Loan caps put the risk of repossession on borrowers because they will walk away from a transaction in which they lose their vehicle with

²⁶⁹ Texas Title Loans, Welcome to Texas Title Loans!, <http://txtitleloans.net/> (last visited Aug. 18, 2011).

²⁷⁰ Davis & Davis Interview, *supra* note xx.

²⁷¹ Magnolia Loans, Title Loans, <http://www.magnolia-loans.com/our-services/loan-services/title-loans/> (last visited Aug. 18, 2011) (“Your title loan can be structured to fit your preference. If you need a cash advance for a short period time and don’t want to make scheduled payments or commit to a long-term loan, a single payment plan might be right for you. On the other hand, if you like to have your payments scheduled so that you know your loan will be paid off after a certain number of payments, an installment plan is probably a better option.”). For an example of a smaller company in Arizona that offers a choice between a balloon product and amortizing product, see Cash-n-Go Title Loans, How It Works, at <http://www.azcashngo.com/vehicle-title-loans-online-how-works.php> (last visited Aug. 22, 2011).

²⁷² See *supra* notes xx – xx and accompanying text.

no vehicle, less money from the loan, and probably no surplus because the equity cushion is likely consumed by repossession costs.²⁷³

Moreover, caps on loan amounts do nothing to protect the poorest title loan borrowers with inexpensive cars because lenders will still loan amounts under the loan cap to these borrowers. At best, loan caps protect the richest title lending customers by preventing loans on high value collateral, but it is unclear why regulators would focus their energy on this group.

The concern with high loan amounts is that borrowers will get in over their heads because lenders will not carefully consider the customer's ability to repay. Yet, loan caps based on dollar amounts are an inapt means of dealing with this problem because they only address mismatches at high levels of income while exhibiting no concern for people getting smaller loans, such as \$2,000, without the means of repaying the loan. Loan caps based on the value of the collateral also ignore the income of the borrower, ensuring the lender is protected by not becoming overextended on the loan but not protecting the borrower. Finally, loan caps focused on income do attempt to solve the problem of ensuring a borrower's ability to repay the debt, but such caps may result in very small loans being made on valuable collateral as lenders attempt to comply with the law, leaving the borrower with lost equity if the lender ends up repossessing because something unexpected prevents repayment. The better solution is to encourage lenders to evaluate ability to repay through disallowing deficiencies. This approach does not prevent borrowers to get the highest loan amount for their vehicle as possible. It emphasizes lenders actually evaluating the borrower's ability to pay instead of lenders attempting to demonstrate compliance with the law.

5. Caps on Prices

Some states cap the cost of loans,²⁷⁴ and high interest rates are a concern to members of Congress.²⁷⁵ For those who are concerned about the cost of title loans but do not want to ban the transaction, price caps are a compelling compromise.

Commentators predict, however, that capping the interest rate will result in lenders adjusting other aspects of the transaction. Zywicki has noted that "term re-pricing" is probably

²⁷³ Of course, if a state does not prevent deficiency claims, laws encouraging higher loan amounts might lead to lenders seeking personal judgments against borrowers. This is another reason to forbid deficiencies.

²⁷⁴ See *supra* notes xx – xx and accompanying text.

²⁷⁵ 155 CONG. REC. S5346-01 (daily ed. May 12, 2009) (statement of Senator Durbin) (“[Y]ou would have to be out of your head to get into that kind of a predicament—a 36-percent annual interest rate. But the fact is Americans right and left are paying much higher interest rates today and don’t know it—payday loans, title loans, installment loans. . . . [I]t is about time we got real here. If we are not going to protect the American consumers when it comes to some of these interest rates, they are going to be very vulnerable to some bad practices.”) 146 CONG. REC. H5179-02 (daily ed. June 27, 2000) (statement of Representative Roukema) (“Abuses in title loans and title pawn transactions often include excessively high interest rates and other exploitive lending practices.”).

less likely in title lending because the loans are “very simple and very transparent loans with a small number of terms.”²⁷⁶

In contrast to Zywicki, I think it is likely that lenders will alter the transaction to account for price caps. The key term in title loans other than price that lenders can adjust, even if other fees are prohibited or other fees are minimal, is the amount they lend to borrowers. If title lenders are constrained in what they can charge, they may lend less money to take on less risk from the transaction. If this occurs, putting a price cap on rates results in borrowers who lose their car forfeiting more money. That these borrowers lose the equity they have amassed in the vehicle is a significant negative for the borrowers who are left the worse off from title loans, so policymakers should avoid setting price terms which may decrease loan amounts.

CONCLUSION

A lot of questions about title lending remain unanswered. Are borrowers overly optimistic about the potential their vehicle will be repossessed or about the likelihood they will repeatedly rollover their loan? Do borrowers have other means of getting to work and doctors' appointments other than the cars they put up as collateral for title loans? Do customers understand the relative cost of title loans?

This Article has offered some preliminary evidence of many of the contested questions involved in title lending by using data from state regulators, public filings, interviews with title lenders, and customer surveys. Based on these data, I argue that states should enact laws specifically directed at title lending that preserve the equity borrowers have in their vehicles.

But, it is clear a lot of work remains to be done before policymakers have the information they need to effectively regulate title lending. Designing a strategy to survey title loan customers involves challenges because title lending stores are not generally very busy, but many of the answers to contested empirical questions will require a research approach that elicits information from the people the policies are being designed to protect—title lending customers.

²⁷⁶ Zywicki, *supra* note xx, at xx.

APPENDIX A

Survey on Auto Title Lending

Contact: Asst. Professor Jim Hawkins, 713-743-5018

Please circle your answer:

1. Why did you take out this auto title loan?

- A. For personal expenses (such as paying bills, getting gas to drive to work, etc.)
- B. For business expenses (anything related to running your own business)
- C. For both personal and business expenses

2. Considering only people living in your same house, how many working vehicles does your family have?

3. How many months total do you anticipate it taking you to *completely* pay off this loan (after all renewals/rollovers)?

- | | | |
|---|----|--------------|
| 1 | 7 | More than 12 |
| 2 | 8 | |
| 3 | 9 | |
| 4 | 10 | |
| 5 | 11 | |
| 6 | 12 | |

4. If you couldn't pay off all your bills one month, which bills would you NOT pay so you could pay on this loan? (Check ALL that apply.)

___ Rent or mortgage payment

___ Utilities (water, electricity, etc)

___ Credit card debt

___ Groceries

___ Medical

___ Other: _____

5. Why did you pick this lender? (Check all that apply.)

Price

Loan amount

Location

Referral from someone

Lender's reputation

Have used this lender previously

Other: _____

6. What do you think is the percentage chance the lender will repossess your vehicle?

_____ %

7. How does the cost of this title loan compare to the cost of a credit card?

- A. This title loan is a lot *less* expensive
- B. This title loan is a little *less* expensive
- C. They are about the same
- D. This title loan is a little *more* expensive
- E. This title loan is a lot *more* expensive.

8. Is the loan you actually took out more money or less money than the loan you were originally wanting to get before you came to the title lending store?

- A. I got less money than I had originally wanted.
- B. I got more money than I had originally wanted.
- C. I got the same amount as I wanted before I came to the lender.

9. How long have you had your loan?

- A. I took my loan out today.
- B. I have had my loan out _____ months.

10. If you could not get a title loan, what would you do?

- A. Get a loan from somewhere else like friends, family, a pawnshop or another lender.

B. Sell my car.

C. Not borrow any money and just make do without a loan.

D. Other: _____