Washington and Lee Law Review

Volume 69 | Issue 2 Article 5

Spring 3-1-2012

Credit on Wheels: The Law and Business of Auto-Title Lending

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Abstract

Despite the fact that they are used by millions of Americans, auto-title loans have received little attention in the legal literature about consumer credit. Friends and foes of title lending make confident statements about their net welfare effects, but we still lack empirical data on many of the central policy questions that title lending raises. This Article offers new 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. Additionally, the Article organizes the different legal responses to title lending, creating a taxonomy of regulatory approaches. Based on the new data uncovered by my research, I offer tentative evaluations of these diverse regulatory strategies.

* Assistant Professor of Law, University of Houston Law Center. I am grateful for comments from Ann Baddour, Ronald Mann, Robert Reich, and the participants of the *Regulation in the Fringe Economy Symposium* at Washington and Lee University School of Law, Columbia Law School's Payday Lending Roundtable, the University of Houston Law Center's Faculty Workshop Series, and a presentation at the University of Alabama School of Law. I am also grateful for the title lenders who participated in interviews. For excellent research assistance, I thank Adam Nalley, Matthew Ezell, Drew Knowles, Joseph Guajardo, and Rebekah Smith. My special thanks go to Mallory Sullivan and Christine Shepard for their hard work organizing a superb symposium. This Article is dedicated with love to Samuel Hawkins, who kept me up from 3 a.m. to 6 a.m. every night for many months, allowing me to complete it.

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I. Introduction

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

1. *See* FEDERAL DEPOSIT INSURANCE CORPORATION, FDIC NATIONAL SURVEY OF UNBANKED AND UNDERBANKED HOUSEHOLDS 10 (2009), *available at* http://www.fdic.gov/householdsurvey/executive_summary.pdf (finding that 25.6% of U.S. households are unbanked or underbanked) [hereinafter FDIC SURVEY].

auto-title loan, is a source of credit for millions of Americans but 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 what is potentially their most valuable asset and their only means of transportation.

Despite the important concerns that 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 II, 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 III, creating a taxonomy of regulatory approaches. States govern title loans by banning them, permitting them to operate despite usury limits through legal carve-outs such as pawnshop laws, and explicitly authorizing and regulating them through statutes geared directly at title lenders.

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2. *See infra* Part II.B.

3. Only two law review articles extensively take up the question of title lending. *See* Todd Zywicki, *Consumer Use and Government Regulation of Title Pledge Lending*, 22 LOY. CONSUMER L. REV. 425, 426 (2010); Nathalie Martin & Ozymandias Adams, *Grand Theft Auto Loans: Repossession and Demographic Realities in Title Lending*, 77 MO. L. REV. 41 (forthcoming 2012).

In light of the business realities of title lending and 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 to return surpluses from sales of collateral but 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.

II. 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. 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,[4] but I also discovered

4. *See, e.g.*, Zywicki, *supra* note 3, at 434 (discussing the size of title loans across the country); Martin & Adams, *supra* note 3, at 68.

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.[5]

Second, I reviewed public disclosure filings by title lenders. Although there are few public companies doing title lending, I examined the bankruptcy filings and security re-characterization filings of TitleMax, one of the nation's largest lenders, and also reviewed another public firm's annual report.

Third, I interviewed title lenders. I spoke with lenders from a variety of types of businesses—large lenders who do only 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 in administering the survey. These two research assistants spent more than fifty hours waiting 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 thirty-five 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 in 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

5. 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 3.

loans that are tied to a pay period,[6] title loans can be originated on any day of the month. We had the most success at a single store, Lone Star Title Loans, simply because it was a much busier store than any other location. A full 85.71% of the completed surveys came from this location, while the others came from a variety of other stores across Houston.[7]

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 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, with the entire balance—principal and interest—due at the end of the month.[8] If the borrower cannot pay the principal, the lender will allow an interest-only payment to roll the loan over for another month.[9]

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6. 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. *See* Nathalie Martin, *1,000% Interest—Good While Supplies Last: A Study of Payday Loan Practices and Solutions*, 52 ARIZ. L. REV. 563, 597 (2010).

7. *See* JIM HAWKINS, SURVEY REPORT ON AUTO TITLE LENDING [hereinafter HAWKINS SURVEY] (on file with the Washington and Lee Law Review).

8. *See* Michael S. Barr, *Banking the Poor*, 21 YALE J. ON REG. 121, 164–65 (2004) (discussing the title loan process).

9. *See* 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) ("Because auto-title loans routinely require repayment soon after the transaction is completed, many customers cannot make the full principal and interest payment when it comes due. As a result, the loan is often extended for another fee (some contracts allow the lender to do so unilaterally).").

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.[10] In a process that takes twenty to forty minutes, the lender evaluates the value of the vehicle, often through the use of commercial guides or proprietary software.[11]

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 only delays inevitable financial breakdowns because people use the loan to pay for normal expenses.[12] 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 use fringe credit products, including pawn loans, payday loans, and rent-to-own.[13] 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

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10. For one example of these requirements, see Advantage Finance, LLC, *Application For Title Loan in Houston, TX*, http://www.cartitleloans houston.com/pages/faqs.html (last visited Apr. 8, 2012) (discussing criteria the company will consider in assessing loan applications) (on file with the Washington and Lee Law Review).

11. *See* TMX Finance, LLC (Form S-4) (Apr. 19, 2011) at 29 (discussing valuation formulae using the Black Book) [hereinafter TMX Finance]; *id.* at 43 (noting the average time to complete a loan transaction).

12. *See* Drysdale & Keest, *supra* note 9, at 599 (observing that title lending "can create a 'debt treadmill' or downward spiral effect that is at the root of much of the concern about cash lending in the fringe market").

13. *See* FDIC SURVEY, *supra* note 1, at 42 (providing empirical evidence for the reasons consumers use fringe credit products).

lost income, 7.4% used it for house repairs or purchasing an appliance, 6.2% used it for special gifts or luxuries, 4.5% used it for car repairs, 2.3% used it for medical expenses, and 26.3% used it for other reasons.[14]

I did uncover one survey specifically aimed at title lending customers, prepared by a large title lender who provided it to me on condition of anonymity. In 2007, the lender's customers in New Hampshire, New Mexico, Kansas, Virginia, and Oregon completed surveys in conjunction with taking out loans.[15] The lender gave participants a $20 loan coupon in exchange for completing the survey. The lender compiled the data by state into a report.[16] In Table 1, I aggregate that data and summarize 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 Borrowers**[17]	**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 include both emergency expenses (roughly 14.2%–29.6% in the FDIC's survey[18] and 92.93% in the

14. *Id.*

15. *See* ANONYMOUS LENDER SURVEY 1 (2007) (on file with the Washington and Lee Law Review) [hereinafter LENDER SURVEY].

16. I obviously am taking this data at face value. I was not involved in designing or administering the survey, so I do not have information about its research design, how it was conducted, or the response rate, beyond the details I have presented here.

17. 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 1,405, but the total number of people providing an occupation was 1,076. Thus, it appears that some people listed multiple reasons for needing the loan, which explains why my percentages add up to more than 100%.

18. These numbers represent those stating their reasons as "house repairs," "car repairs," and "medical expenses" (equaling 14.2%) plus those

lender's survey[19]) and regular expenses (roughly 38% in the FDIC's survey[20] and 28.09% in the lender's survey[21]). Thus, the policy question is more difficult than just labeling the use of title loans as either purely emergency or purely routine spending. It appears to involve both.

Another factor complicating any analysis of loan use is that people may report that they used the loan for one purpose when they in fact used it as spending money for other purposes. For instance, someone may claim to be using a loan to pay rent, but the person may only need the money because of gambling losses from earlier in the month. Without a comprehensive budget, survey data about loan use is difficult to assess.

A similar ambiguity exists about whether a significant portion of loans is taken out 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.[22] Zywicki estimates that 25% to 30% of title lending customers fit into this category.[23] People within the industry confirm that many title loan customers are small business owners who use their vehicles as a source of capital to operate their businesses.[24] TitleMax's securities

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stating their reason was "lost income" (15.4%), depending on whether one considers this to be an emergency expense or not. *See* FDIC SURVEY, *supra* note 1, at 43, 67 (compiling survey responses into Table A-20: Reasons Underbanked Households Use AFS Credit).

19. This number represents those stating their reasons as "car maintenance/repair," "unusually high utility bill," "unexpected medical emergency," or "delay in payment of expected income/missed paycheck." *See* LENDER SURVEY , *supra* note 15.

20. This number represents those stating that they needed the loan for "basic living expenses." *See* FDIC SURVEY, *supra* note 1, at 43, 67.

21. This number represents those stating that they needed the loan for "help with mortgage/rent." LENDER SURVEY, *supra* note 15, at 1.

22. *See* Zywicki, *supra* note 3, at 449 ("Many such businesses do not have access to small business loans and rely on consumer credit, such as credit cards, home equity loans, auto title loans, and other sources of consumer lending to finance their business operations.").

23. *Id.*

24. *See* Interview with Anonymous Director of Government Affairs, Large Title Lending Company (Dec. 14, 2010) [hereinafter Anonymous Interview] (noting that the company only makes consumer loans but that "a significant percentage of our customer base owns their own business") (on file with the Washington and Lee Law Review); *see also* Interview with Tommy Davis,

filing states that customers are often "self-employed small business owners with an immediate need for short-term working capital."[25] Even a member of Congress has claimed that title loans can help save small businesses from failing.[26]

In the anonymous title lender survey, 19.70% (n = 212) of customers identified themselves as self-employed.[27] 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 look 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."[28]

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. I clarified that "Personal Expenses" would include buying gas to get to work. Among those we surveyed,

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President & Justin Davis, Vice-President, TJD Financial Services, Inc. (Aug. 24, 2011) [hereinafter Davis & Davis Interview] (estimating that 10% of their loans are for business purposes) (on file with the Washington and Lee Law Review); Interview with Thomas Cone, General Manager, Magnolia Title Loans (Sept. 20, 2011) [hereinafter Cone Interview] (estimating that 20% of his company's loans are for business purposes) (on file with the Washington and Lee Law Review); Dena Potter, *Va. Car Title Lending Law Takes Effect Friday*, BLOOMBERG BUSINESS WEEK (Sept. 29, 2010), http://www.businessweek.com/ap/financial news/D9IHLNUO1.htm (last visited Apr. 8, 2012) ("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 [sic] in order to run their businesses.") (on file with the Washington and Lee Law Review).

25. *See* TMX Finance, *supra* note 11, at 40.

26. *See* 146 CONG. REC. H5179-02 (daily ed. June 27, 2000) (statement of Rep. McCollum) ("This emergency credit can keep a small businessman from going under, or cover immediate needs at the end of the month.").

27. *See* LENDER SURVEY, *supra* note 15, at 1.

28. *Id.*

25.71% (n = 9) said they were using the loan at least in part to run their own business.[29]

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. One concern is that title lending causes financial distress in allowing borrowers to take on excessive debt loads. Another perception is that title lenders strip equity from borrowers by lending them only a small percentage of the value of their vehicles. We can measure how much title lenders give to customers in a variety of ways: (1) the amount lent in absolute dollars, (2) the amount lent relative to the value of the vehicle, or (3) 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 that reveal how much, in absolute dollars, title loan companies lend to customers. An earlier academic study reports that the average advance is $275.[30] EZCORP, a public company that does title lending, states in its annual report that $700 is its average loan amount;[31] TitleMax states in a securities filing that "[o]ur customers borrow on average approximately $1,100 and $850 at our TitleMax and TitleBucks stores, respectively";[32] and one smaller Texas-based firm reported its average loan was for $1,000.[33] State regulators report averages of $793.80 in Illinois,[34] $562 in Montana,[35] $847

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29. *See* HAWKINS SURVEY, *supra* note 7, at 1.

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

31. *See* EZCORP, Inc., Annual Report (Form 10-K), at 6 (Dec. 14, 2009) [hereinafter EZCORP, Inc.].

32. *See* TMX Finance, *supra* note 11, at 41.

33. *See* Davis & Davis Interview, *supra* note 24, at 1.

34. *See* ILL. DEPT. OF FIN. & PROF. REG., PAYDAY LOAN CONSUMER REPORTING SERVICE, TITLE LOAN AGGREGATE DATA: OCTOBER 2009 THROUGH JUNE 2011 2 [hereinafter ILLINOIS REPORT] (on file with the Washington and Lee Law

in Virginia,[36] and $243 in Oregon.[37] The modal amount of a title loan (representing 40% of agreements) in Tennessee was $251–$500.[38]

Each of these data points reflects the laws in the jurisdictions reporting them. Oregon, for instance, limits lenders to charging an annual percentage rate (APR) of 36% but allows them to charge a one-time fee of $30, which appears to cause lenders to lend close to $300.[39] Tennessee caps loans at $2,500,[40] 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.[41] 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 does suggest that title loans are generally for small amounts. Martin and Adams have argued, however, that title "loans are by no means small."[42] 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

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35. *See* MONT. DIV. OF BANKING & FIN. INSTS., COMPOSITE REPORT OF OPERATIONS OF MONTANA TITLE LOAN LICENSEES: CALENDAR YEAR 2009 1 [hereinafter 2009 MONTANA REPORT] (on file with the Washington and Lee Law Review).

36. *See* VA. STATE CORP. COMM., BUREAU OF FIN. INSTS., THE 2010 ANNUAL REPORT OF THE PAYDAY LENDER LICENSEES, CHECK CASHERS, MOTOR VEHICLE TITLE LENDER LICENSEES 84, *available at* http://www.scc.virginia.gov/bfi/annual/ar04-10.pdf [hereinafter VIRGINIA REPORT].

37. *See* OR. DEP'T OF CONSUMER AND BUS. SERVS., DIV. OF FIN. AND CORP. SEC., OREGON LICENSED CONSUMER FINANCE COMPANIES 2 (2009), *available at* http://www.cbs.state.or.us/external/dfcs/cf/annual_reports/2009.pdf [hereinafter 2009 OREGON REPORT].

38. *See* TENN. DEP'T OF FIN. INST., 2010 REPORT ON THE TITLE PLEDGE INDUSTRY 6, *available at* http://www.tennessee.gov/tdfi/compliance/tpl/TPL Report2009Final.pdf [hereinafter 2010 TENN. REPORT].

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

40. *See* TENN. CODE ANN. § 45-15-115(3) (2005) (setting limitations on title lenders).

41. *See* CAL FIN. CODE § 22303 (1995) (making interest rate restrictions inapplicable to any "bona fide principal amount" of $2,500 or more).

42. Martin & Adams, *supra* note 3, at 48 n.37.

$42,000."[43] These single examples are hardly representative and, thus, provide poor evidence of what standard amounts may be. Aggregate data from Montana, for instance, indicates that only 0.42% of loans in 2009 were for more than $4,000,[44] while 97.41% of loans were for less than $2,000.[45] In Tennessee, in 2008, "only 3% were made for amounts between $2,251 and $2,500 which is the maximum loan amount permitted by law."[46] Thus, while it is difficult to make generalizations, it appears that title loans are often 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 cite very different ratios, ranging from "about 25% of the wholesale value of the car"[47] to 80% of the value of the vehicle.[48]

Similarly, lenders I interviewed gave me a range of percentages for how much they will lend. One said it typically lends 50% of the wholesale value of the car;[49] another said it lends 33% to 80% of the Black Book[50] value of the vehicle depending on the year and condition of the car;[51] and yet another reported that it

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43. *Id.*

44. This represents 53 loans of 12,727. 2009 MONTANA REPORT, *supra* note 35, at 1.

45. This represents 12,397 of 12,727 loans. *Id.*

46. 2010 TENN. REPORT, *supra* note 38, at 6.

47. CASKEY, *supra* note 30, at 44.

48. *See* Webinar: *Baby, You Can Take My Car: The Dangers of Auto Title Loans*, NAT'L CONSUMER L. CTR. (July 15, 2010), http://www.nclc.org/images/pdf/conferences_and_webinars/auto_webinars/recordings/recording_july15.wmv (last visited Apr. 8, 2012) [hereinafter NCLC Webinar] (remarks of Leslie Parrish, Senior Researcher for the Center of Responsible Lending) (reporting that she has seen loan-to-value ratios of 80%) (on file with the Washington and Lee Law Review).

49. Anonymous Interview, *supra* note 24.

50. The Black Book is a regularly published guide that provides the value of cars sold at auctions. *See* Black Book, *Overview*, http://www.blackbookusa.com/home.aspx?m=2&s=1&t=D&i=20 (last visited Apr. 8, 2012) (on file with the Washington and Lee Law Review).

51. Interview with Robert Reich, President, Community Loans of America (Jan. 18, 2011) [hereinafter Reich Interview] (on file with the Washington and

lends 40% to 70% of the Kelly Bluebook wholesale value of a vehicle.[52] Industry giant TitleMax went through a Chapter 11 bankruptcy recently and, in a disclosure statement sent to creditors, stated, "Using 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."[53] 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.[54]

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 "too low." On the one hand, those concerned with borrowers' ability to repay the loans complain that loan amounts are too high.[55] On the other hand, those worried that borrowers lose equity when title lenders repossess consumers' vehicles and do not return the surpluses argue that lenders do not lend sufficiently

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52. *See* Interview with Alex Vaugh, Vice-President of Government Relations, Cash America, Inc., and Shawn Bourns, Director in Operations Development of Retail Service, Cash America, Inc. (Nov. 22, 2010) [hereinafter Vaugh & Bourns Interview] (on file with the Washington and Lee Law Review).

53. Disclosure Statement for Plan of Reorganization of Titlemax Holdings, L.L.C., at 4–5, *In re* Titlemax Holdings, L.L.C., 447 B.R. 896 (Bankr. S.D. Ga. 2010) (09–40805), ECF No. 390 [hereinafter Titlemax Disclosure Statement].

54. TMX Finance, *supra* note 11, at 42; *see also id.* at 29 ("At origination, our weighted average loan amount is approximately 69% of appraised wholesale value and approximately 25% of the Black Book retail value.").

55. *See infra* Part III.A.1.c.

high percentages of the vehicles' value.[56] Moreover, research indicates that higher loan amounts may actually decrease the likelihood of default.[57]

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.[58] More pointedly, members of Congress and others claim that lenders benefit when they repossess and sell vehicles because they retain the surplus from the transaction.[59] Yet another common charge against title

56. *See* 146 CONG. REC. H5179-02 (daily ed. June 27, 2000) (statement of Rep. Mascara).

57. *See* Will Dobbie & Paige Marta Skiba, *Information Asymmetries in Consumer Credit Markets: Evidence from Payday Lending* 2 (Vanderbilt Univ. Sch. of Law & Econ., Working Paper No. 11-05, 2011) ("Our regression discontinuity estimates suggest that a $100 increase in loan size decreases the probability that a borrower defaults by 2.8 to 3.8 percentage points. This is a 22 to 35 percent decrease from the mean default rate.") (on file with the Washington and Lee Law Review); *see also* Colleen Creamer, *Payday Loans: Taking the Good with the Bad*, 35 NASHVILLE LEDGER 33 (2011) ("I think that raising the limit actually may be a good thing for borrowers . . . . [W]hen 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." (internal quotation marks omitted)).

58. *See* Annesley H. DeGaris, *Car Title Lending*, 2 AMERICAN ASSOCIATION FOR JUSTICE: AAJ ANNUAL CONVENTION REFERENCE MATERIALS 1 (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"); *see also* Martin & Adams, *supra* note 3, at 41 ("A title loan is a high-interest, deeply over-secured, consumer loan . . . ."); *see also* 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 (last visited Apr. 8, 2012) ("The loan-to-value ratio is rarely greater than 33 percent, making it a win-win situation for the lender if the borrower defaults.") (on file with the Washington and Lee Law Review).

59. *See* 146 CONG. REC. S167-05 (daily ed. Feb. 1, 2000) (statement of Sen. 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."); *see also* 146 CONG. REC. H5179-02 (daily ed. June 27, 2000) (statement of Rep. 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."); *see also* DeGaris, *supra* note 58, at 2

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.[60]

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 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.[61] 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 fifty-two 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 sale;[62] another confirmed that "[r]epossessions, at best, are a breakeven process and most often simply mitigate our loss."[63] Tennessee's report from 2007 found

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("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.").

60. *See* Martin & Adams, *supra* note 3, at 32.

61. *See* 2010 TENN. REPORT, *supra* note 38, at 8. Other years in Tennessee are similar. *See* TENN. DEP'T OF FIN. INSTS., 2008 REPORT ON THE TITLE PLEDGE INDUSTRY 7–12, *available at* http://www.state.tn.us/tdfi/compliance/tpl/TPLReport2008FinalFinal.pdf [hereinafter 2008 TENN. REPORT] (noting that, in 2006, Tennessee lenders returned $1,256,068 to customers but had $11,394,220 in unrecovered principal); TENN. DEP'T OF FIN. INSTS., REPORT ON THE TITLE PLEDGE INDUSTRY: A SUPPLEMENT TO THE 2006 REPORT TO THE TENNESSEE GENERAL ASSEMBLY 7, *available at* http://www.tn.gov/tdfi/compliance/tpl/2007TPLSupplementalReport-FINAL.pdf [hereinafter 2006 TENN. REPORT SUPP.] (reporting that, in 2007, title lenders returned $171,579 to customers but had $5.1 million in unrecovered principal).

62. Reich Interview, *supra* note 51, at 1.

63. Anonymous Interview, *supra* note 24, at 5–6 .

firms spent, on average, $92.10 for repossession, $72.05 for storing vehicles until sale, and $4.02 for advertisements.[64] 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.[65]

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, 0.06% of loans in 2005[66] and 0.20% of loans in 2006[67] resulted in lenders obtaining a money judgment against a borrower. Lenders[68] and even consumer advocates[69] maintain that lenders generally do not pursue deficiencies even when it is legal to do so.

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64. *See* TENN. DEP'T OF FIN. INSTS., 2006 REPORT TO THE TENNESSEE GENERAL ASSEMBLY 7–9, *available at* http://www.tn.gov/tdfi/compliance/tpl/2006GeneralAssemblyReportTitlePledge.pdf [hereinafter 2006 TENN. REPORT].

65. *See* Davis & Davis Interview, *supra* note 24, at 2.

66. *See* OR. DEP'T OF CONSUMER AND BUS. SERVS., DIV. OF FIN. AND CORP. SEC., OREGON LICENSED CONSUMER FINANCE COMPANIES 2005 SHORT-TERM LOANS 2, *available at* http://cbs.state.or.us/external/dfcs/cf/annual_reports/ 2005.pdf (reporting that 12 title loan transactions out of 17,801 resulted in the lender obtaining a money judgment).

67. *See* OR. DEP'T OF CONSUMER AND BUS. SERVS., DIV. OF FIN. AND CORP. SEC., OREGON LICENSED CONSUMER FINANCE COMPANIES 2006 SHORT-TERM LOANS, *available at* http://cbs.state.or.us/external/dfcs/cf/annual_reports/ 2006.pdf [hereinafter 2006 OREGON REPORT] (reporting that lenders obtained money judgments on only 31 of 15,726 title loans).

68. For instance, although Texas law permits it to seek deficiencies, TDJ Financial Services never has in its eleven years operating in the state. *See* Davis & Davis Interview, *supra* note 24, at 2. The American Association of Responsible Auto Lenders (AARAL) also claims its members will not seek deficiencies. *See* AARAL, *AARAL Best Practices Safeguard Consumers*, http://www.responsibleautolenders.org/bestpractices/ (last visited Jan. 10, 2012) ("Repossession of a consumer's vehicle is rare and occurs only as a last resort. Should repossession occur, all proceeds from the sale of the vehicle in excess of the loan balance are returned to the consumer.") (on file with the Washington and Lee Law Review).

69. *See* NCLC Webinar, *supra* note 48 (remarks of Jay Speer, Executive Director, Virginia Poverty Law Center & Sarah Mattson, Policy Director/NH Health Law Collaborative Director, New Hampshire Legal Assistance) (noting that, generally, after a title lender repossesses a car, "that is it").

Based on this data, a disturbing asymmetry of title lending emerges. Even though, from the lenders' perspective, they do not have much to gain from repossessing a car (because the loans are not technically oversecured), borrowers have a lot to lose, because their equity in the vehicle is consumed by the costs of repossession and resale.[70] 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.[71] This argument

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70. *See* Ronald J. Mann, *Verification Institutions in Financing Transactions*, 87 GEO. L.J. 2225, 2244–45 (1999) (describing this asymmetry as a common feature in collateralized loans). Mann notes:

> [L]enders 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.

Id. (citation omitted).

71. *See, e.g.*, NCLC Webinar, *supra* note 48 (remarks of Sarah Mattson) (asserting that title loans are predatory because they are asset-based and indifferent to a borrower's ability to repay); David Ress, *Draft Regulations for Car-Title Loans Draw Lenders' Fire*, RICHMOND TIMES-DISPATCH, 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 [consumer] group's lawyer, David W. Clarke, added."); Jean Ann Fox & Elizabeth Guy, *Driven into Debt: CFA Car Title Loan*

has had traction with policymakers,[72] and title loan customers have sued because title lenders do not consider ability to repay.[73]

On the other hand, the title lenders assert that they try to make repayment manageable. The lenders I interviewed all said that they consider customers' ability to repay,[74] and some lenders' websites tell customers to bring proof of income, which suggests they consider ability to repay.[75] EZCORP's annual report tells

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Store and Online Survey, CONSUMER FED. OF AM. 2 (2005), *available at* http://www.consumerfed.org/pdfs/Car_Title_Loan_Report_111705.pdf ("Lenders don't run credit checks or base loans on the borrower's ability to repay. Loans are generally due in one month, with interest only renewals available."); Martin & Adams, *supra* note 3, at 48 ("[T]he amount of each loan is unrelated to a person's income; the amount is based solely upon the value of the vehicle used as collateral.").

72. *See* Press Release, Governor Lynch's Veto Message Regarding SB 57 (July 6, 2011), http://www.governor.nh.gov/media/news/2011/070611-sb57.htm (last visited Apr. 8, 2012) [hereinafter Lynch Press Release] ("At the same time, 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.") (on file with the Washington and Lee Law Review).

73. *See* Lester v. TitleMax, Inc. (*In re* TitleMax Holdings, LLC), 447 B.R. 896, 903 (Bankr. S.D. Ga. 2010) (remanding to state Court of Common Pleas). Before remanding, the bankruptcy court briefly noted the thrust of the suit:

> 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.

Id. at 898 (citations omitted).

74. *See* Reich Interview, *supra* note 51, at 2. (stating that his company asks about income to make sure the customer can pay the monthly installment); Anonymous Interview, *supra* note 24, at 2 ("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 24, at 1 (emphasizing the central importance the company places on the customer's ability to repay); Vaugh & Bourns Interview, *supra* note 52, at 1 (asserting that Cash America's product was designed to ensure that the customer could pay off the loan).

75. *See* Auto Cash, USA, *Car Title Loan Required Items*, http://www.autocashusa.com/title-loan-required-items.php (last visited Apr. 8, 2012) ("When you

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."[76] An industry trade organization, the American Association of Responsible Auto Lenders, states on its "Best Practices" webpage that its members "keep consumers' payments low enough so they are able to successfully pay off the loan . . . ."[77] 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 the lender can ensure that customers can repay their obligations.[78]

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 their 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.

3. Are Title Borrowers Overly Optimistic About Rollovers?

One important concern about title lending is whether borrowers are overly optimistic when they begin the title loan transaction about how many times they will roll over 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."[79]

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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.") (on file with the Washington and Lee Law Review).

76. EZCORP, Inc., *supra* note 31, at 6.

77. *See* AARAL, *supra* note 68 ("AARAL member companies keep consumers' payments low enough so they are able to successfully pay off the loan and get their title back.").

78. *See* The Loan Depot, *Apply for a Loan*, http://www.yourloandepot.com/apply_for_a_loan.php (last visited Apr. 8`, 2012) (on file with the Washington and Lee Law Review).

79. Ronald H. Silverman, *Toward Curing Predatory Lending*, 122 BANKING L.J. 483, 491 (2005). One news story pointed out that title-lending customers operate on a "false hope." Arnold, *supra* note 58. In the context of payday lending, however, scholars have expressly stated that borrowers are overly

The optimism bias is one of the most robustly established biases in the literature on behavioral economics.[80] 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; 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.[81]

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)?"[82] 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 amounted to eighteen customers. Of 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.[83] Because virtually all accounts suggest higher numbers of rollovers among actual borrowers in similar situations,[84] the people we surveyed were overly optimistic about the likelihood they would pay off their loan quickly.

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optimistic about how many times they will roll over their loans. *See, e.g.*, Oren Bar-Gill & Elizabeth Warren, *Making Credit Safer*, 157 U. PA. L. REV. 1, 44–45 (2008) ("A customer who misestimates her ability to repay the loan in fourteen days will likely roll the loan over for another fourteen days. Payday lenders target such customers, amassing 90% of their profits from borrowers who roll over their loans five or more times during a year."); Alan White, *Behavior and Contract*, 27 LAW & INEQ. 135, 161–62 (2007) ("The payday lenders, even by naming their product, actively seek to encourage the consumer's mistaken idea that the loan is very short-term and low-cost.").

80. *See, e.g.*, Ron Harris & Einat Albin, *Bankruptcy Policy in Light of Manipulation in Credit Advertising*, 7 THEORETICAL INQ. L. 431, 434 (2006) (discussing optimism bias in the context of student loans).

81. *See, 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) ("Respondents' predictions for the permanence of their own marriages and the consequences should they be divorced were much more optimistic than their perceptions of the likelihood and effects of divorce for others.").

82. *See* HAWKINS SURVEY, *supra* note 7, at 1.

83. *Id.*

84. Industry insiders and state regulators report a variety of different

4. Costs of Title Loans

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.[85] 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."[86] Without a doubt, interest rates are high.

Members of Congress have expressed concern that title borrowers "are unaware of applicable rates,"[87] but one study of title lending argues that title loans "have highly transparent and easily understood pricing schemes."[88] 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) recognized 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.[89] 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.

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lengths of payoff time. *See, e.g.*, 2008 TENN. REPORT, *supra* note 61, at 6 (reporting seven rollovers on average in Tennessee); NCLC Webinar, *supra* note 48 (recounting the TitleMax CEO's observation that customers renew eight times on average); AARAL, *supra* note 68 ("Most loans are paid back in six months or less."). *But see* Anonymous Interview, *supra* note 24, at 3 ("Most customers have paid off their loan within 90 days.").

85. *See, e.g.*, Wisconsin Auto Title Loans, Inc. v. Jones, 714 N.W.2d 155, 179 (Wis. 2006) (Butler, J., concurring) ("Predatory lenders exploit borrowers through excessively high interest rates."); TMX Finance, *supra* note 11, at 21 ("The consumer advocacy groups and media reports generally focus on the cost to a consumer for this type of loan . . . ."); Lynch Press Release, *supra* note 72 ("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.").

86. Fox & Guy, *supra* note 71, at 2.

87. H.R. Con. Res. 312, 106th Cong. (2000).

88. Zywicki, *supra* note 3, at 437.

89. *See* HAWKINS SURVEY, *supra* note 7.

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.[90] Title lenders themselves note the important role nonfinancial issues such as staffing, location, and the cleanliness of facilities play in capturing business.[91] Some academics go further to claim that there is virtually no price competition in fringe lending markets like payday lending.[92]

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 its competitors."[93] Similarly, EZCORP tells investors that competitive pricing is a "primary element[] of competition."[94]

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90. *See, e.g.*, Zywicki, *supra* note 3, at 391 ("[N]ontraditional lenders compete intensely on nonfinancial margins: As noted, they offer longer hours, provide highly-personalized customer service, and have many more storefronts than traditional lenders, competing on convenience."); Robin A. Prager, *Determinants of the Locations of Payday Lenders, Pawnshops and Check-Cashing Outlets* 15 (Fed. Res. Bd., Div. of Research & Statistics, FEDS Working Paper No. 2009-33, 2009); *available at* http://www.federalreserve.gov/pubs/feds/2009/200933/200933pap.pdf (observing that alternative financial service providers locate near customers based on a variety of sociological factors).

91. *See, e.g.*, Reich Interview, *supra* note 51, at 5 (noting the importance of having a visible location and treating customers well); Anonymous Interview, *supra* note 24, at 7 ("We rely on television and radio marketing, friendly and trust-worthy service, [and] attractive locations in accessible parts of town."); EZCORP, Inc., *supra* note 31, 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* note 53, at 5 ("The success of the Debtors' business is attributable to several factors including, but not limited to . . . employ[ing] a highly-motivated and well-trained sales force that accurately judge [sic] the appropriate amount of the Customer Loan [and] the Debtors have highly visible locations and brand recognition.").

92. *See* ROBERT MAYER, QUICK CASH: THE STORY OF THE LOAN SHARK 54–56 (2010) (attributing the lack of competition in fringe lending to "information failure," due to lenders' concealment of charges and borrowers' failure to search for the lowest prices).

93. Titlemax Disclosure Statement, *supra* note 53, at 5.

94. EZCORP, Inc., *supra* note 31, at 11.

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."[95] Some companies even make cost comparisons for customers between themselves and other companies.[96]

Different companies appear to offer different rates. In Tennessee, regulators determined that 53% of companies charged 22% a month, the maximum rate allowed by law, while the other 47% of companies charged between 10% and 21% a month.[97] In Oregon, in 2006, before interest rates were capped at 36%, the maximum rate charged was 663%, but the average rate was 318%.[98] As a local example, companies in Houston charge rates ranging from 217.7%,[99] to 144.95%,[100] to 114.0%.[101]

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95. Sugar Land Car Title Loans, http://www.sugarlandtitleloans.com/index.html (last visited Apr. 8, 2012) (on file with the Washington and Lee Law Review); *see also* Magnolia Loans & Insurance, *Title Loan FAQs*, http://www.magnolia-loans.com/faqs/title-loan-faqs/ (last visited Apr. 8, 2012) (advertising its ability to offer cheaper loans than its competitors because Magnolia has "fewer expenses" and is "honest and straightforward and believe[s] in making quality loans that people can afford to pay back") (on file with the Washington and Lee Law Review).

96. *See, e.g.*, Advantage Finance, *Houston Car Title Loans From Advantage Finance LLC*, http://www.cartitleloanshouston.com/ (last visited Apr. 8, 2012) (comparing itself to two other types of title loan products) (on file with the Washington and Lee Law Review).

97. 2010 TENN. REPORT, *supra* note 38, at 10–11.

98. 2006 OREGON REPORT, *supra* note 67, at 1.

99. *See* Texas Title Loans, http://txtitleloans.net/ (last visited Apr. 8, 2012) (comparing its rates to those of competitors with an amortization table) (on file with the Washington and Lee Law Review).

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

101. *See* Advantage Finance, *Houston Car Title Loans From Advantage Finance LLC*, http://www.cartitleloanshouston.com/ (last visited Apr. 8, 2012) (comparing its rates to those of competitors with an amortization table) (on file with the Washington and Lee Law Review).

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 subpart 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,[102] assert without offering any proof that lenders "often" repossess people's cars.[103] Even some of those interpreting evidence about repossessions have reported misguided information about how often lenders 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 from 35% to over 50% of loans in Tennessee result in the title lender repossessing the vehicle.[104] To come up with this figure, she took the total number of title loan agreements reported in Tennessee and divided it by the number of times customers roll over or renew the loans on average. She compared that figure to the number of repossessions and concluded that the repossession rate is between 35% and 50%, depending on

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102. *See* 146 CONG. REC. 12,524 (2000) ("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)).

103. *See, e.g.*, DeGaris, *supra* note 58, at 2 ("A title loan *often* ends in repossession." (emphasis added)); Arnold, *supra* note 58 ("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 (Lynchburg, VA), Dec. 10, 2008, http://www2.newsadvance.com/news/2008/dec/10/newest_form_of_predatory_lending_strikes-ar-220374/ (last visited Apr. 8, 2012) ("Another consequence of car title loans is a high repossession rate.") (on file with the Washington and Lee Law Review); Silverman, *supra* note 79, at 491 ("In cases of default, lenders are quick to repossess and sell the car . . . .").

104. *See* Jean Ann Fox, *Fringe Bankers: Economic Predators or New Financial Services Model?,* 30 W. NEW ENGL. L. REV. 135, 140 (2007) ("Consumers who pledge car titles as security for small loans run the risk of losing their vehicle.").

whether we assume borrowers roll over their loans three or seven times.[105]

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,[106] the report Fox was using is unclear on this point, so her confusion is understandable.[107] 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.[108] 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.[109] 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."[110] 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

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105. *Id.* Fox notes:

> 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.

Id.

106. The report generated in 2008 concerning data from 2006 explicitly states that the "total number of [title pledge] agreements" "reflects new agreements made and does not include renewals of these initial agreements." 2008 TENN. REPORT, *supra* note 61, at 4.

107. *See* 2006 TENN. REPORT SUPP., *supra* note 61, at 7 (stating the total title pledge agreement figure without explaining whether it incorporates rollovers into that figure or not).

108. E-mail from Steve Henley, Tenn. Dep't of Fin. Insts., to Jim Hawkins (Aug. 4, 2011, 14:33 CST) (on file with the Washington and Lee Law Review).

109. *See* WOODSTOCK INST. & PUB. ACTION FOUND., DEBT DETOUR: THE AUTOMOBILE TITLE LENDING INDUSTRY IN ILLINOIS 5 (2007).

110. *Id.*

from the borrower.[111] 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.

Nathalie Martin and Ozymandias Adams state in a new paper, based on reports from New Mexico, that "between 20% and 71% of the title loan customers have their vehicles repossessed."[112] Martin and Adams's 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.[113] 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.[114] 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.[115]

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."[116] This introduces some unknown

111. *See id.* at 2 (explaining that the statistics generated in the report are based on an analysis of cases filed against title borrowers).

112. Martin & Adams, *supra* note 3, at 45. In another article, Martin suggests that one-third of borrowers lose their cars. *See* Nathalie Martin, *Regulating Payday Loans: Why This Should Make the CFPB's Short List*, 2 HARV. BUS. L. REV. 1446 (2011), *available at* http://www.hblr.org/wp-content/uploads/ 2011/07/Martin-Payday-Loans.pdf.

113. Martin & Adams, *supra* note 3, at tbl.4.

114. *Id.* at 80.

115. *Id.* at 64.

116. *Id.*

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.[117] 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.

Finally, Todd Zywicki finds that around 8% of loans lead to repossession based on state reports and interviews with title lending companies.[118] 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.[119] 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,[120] and that 5% to 6% of customers lose their vehicles.[121] News stories report the nation's largest lender stating that the repossession rate per

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117. 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.

118. *See* Zywicki, *supra* note 3, at 435.

119. *See* Adam Levitin, *Auto Title Lending Data*, CREDIT SLIPS (Jan. 14, 2011 11:50 PM), http://www.creditslips.org/creditslips/2011/01/auto-title-lending-data.html (last visited Apr. 8, 2012) ("[Zywicki's data] 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.") (on file with the Washington and Lee Law Review).

120. Anonymous Interview, *supra* note 24, at 5.

121. *See* E-mail from Anonymous Title Lender to Jim Hawkins (Jan. 1, 2011, 15:13 CST) ("Our average national repossession rate is between 5 and 6%. This is based on a ratio of repossession per customer not loans.") (on file with the Washington and Lee Law Review).

customer is 7%.[122] 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.[123] Similarly, another Texas lender with two stores indicated that 7.2% of its loans result in repossession, meaning roughly 10% of borrowers lost their vehicles.[124]

I have combined the data from the six states' reports in Table 2 below. None of the states report 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.[125]

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

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122. *See* Richard Locker, *No Progress on Title-Lending Bill: Coalition, Industry Pitch Sides, but Panel OKs Nothing*, KNOXVILLE NEWS SENTINEL, July 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 '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.").

123. Davis & Davis Interview, *supra* note 24.

124. Cone Interview, *supra* note 24.

125. I have e-mails from regulators in Tennessee and Montana that confirm the number of loan agreements does not include rollovers or renewals. *See* E-mail from Steve Henley, Tenn. Dep't of Fin. Insts., to Jim Hawkins (Aug. 4, 2011, 14:33 CST) (on file with the Washington and Lee Law Review); E-mail from Linda Leffler, Mont. Div. of Banking & Fin. Insts., to Jim Hawkins (Aug. 5, 2011, 16:57 CST) (on file with the Washington and Lee Law Review). The Illinois report plainly does not 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. *See* 2009 OREGON REPORT, *supra* note 37, at 2. 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. *See* VIRGINIA REPORT, *supra* note 36, at 84.

much higher than the repossession rate per new loan because the lengths of loans reported in different states are all quite high. Few customers could have more than one loan out during the year.

Table 2: Repossession Rates on New Title Loans

State	**Year**[126]	**Number of New Title Loan Agreements**	**Number of Repossessions**[127]	**Repossession Rate**
Tennessee[128]	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[129]	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%
Idaho[130]	2010	34,247	2382	6.96%
Illinois[131]	Oct. 2009–June 2011	155,094	7,334	4.73%
Montana[132]	2009	12,727	599	4.71%
Virginia[133]	Oct. 2010–Dec. 2010	24,975	194[134]	0.78%

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

126. The year noted in Table 2 represents the year the data were gathered, not the year the data were reported.

127. These figures exclude cases in which customers redeemed repossessed collateral because in those cases customers did not in fact lose their vehicles.

128. To view these reports, see TENN. DEP'T OF FIN. INSTS., *Title Pledge Reports*, http://www.tn.gov/tdfi/compliance/tpl/TPLreports.html (last visited Apr. 8, 2012) (on file with the Washington and Lee Law Review).

129. To view these reports, see OR. DIV. OF FIN. AND CORP. SEC., *Consumer Finance, Payday, and Title Lending Annual Activity*, http://www.cbs.state.or.us/external/dfcs/activity_reports/consumer_finance.html (last visited Apr. 8, 2012) (on file with the Washington and Lee Law Review).

130. On file with the Washington and Lee Law Review.

131. On file with the Washington and Lee Law Review.

132. On file with the Washington and Lee Law Review.

133. *See generally* VIRGINIA REPORT, *supra* note 36.

134. This number likely overstates the number of vehicles consumers lost because the report states that only two vehicles were sold by lenders, indicating customers redeemed some repossessed vehicles. *Id.* at 84.

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.[135] 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.[136] 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.[137] Legislators have even 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."[138]

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

135. *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.").

136. Arnold, *supra* note 58.

137. *See* Jean Braucher, *Theories of Overindebtedness: Interaction of Structure and Culture*, 7 THEORETICAL INQUIRIES 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."); *see also* Dave Ress, *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 he has given the lender a lien on his vehicle and that he may lose his vehicle if he doesn't repay . . . . This will not necessarily be clear to the borrower unless he is required to surrender his title.'" (quoting James W. Speer, executive director of the Virginia Poverty Law Center) (internal quotation marks omitted)).

138. 156 CONG. REC. S3021 (daily ed. May 3, 2010) (statement of Sen. Durbin).

loan out. 54.29% (n = 19) of those we surveyed predicted a 0% chance that 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.[139] 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 a 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 bills[140] and gives lenders substantial bargaining leverage over borrowers.[141] It is not the value of the

139. Four people predicted a 10% chance, one person predicted a 15% chance, two people predicted a 20% chance, one person predicted a 30% chance, two people predicted a 50% chance, one person predicted a 70% chance, and two people mysteriously predicted a 100% chance. Two people did not answer this question. See HAWKINS SURVEY, *supra* note 7.

140. *See, e.g.*, DEP'T OF DEFENSE, REPORT ON PREDATORY LENDING PRACTICES DIRECTED AT MEMBERS OF THE ARMED FORCES AND THEIR DEPENDENTS 7, 44 (2006) [hereinafter DOD 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[s] the borrower to consider loan payments as being their top priority."); NCLC Webinar, *supra* note 48 (remarks of Leslie Parrish) (arguing that title loans cause borrowers to drop their other bills to make sure they pay on their title loan); *Id.* (remarks of Jay Speer) (reporting that two people seeking legal help claimed they would pay down their title loan before they paid their rent).

141. *See* DOD REPORT, *supra* note 140, at 7; *see also* NCLC Webinar, *supra* note 48 (remarks of Sarah Mattson) (asserting that title lenders use the powerful leverage of repossession over consumers in negotiations to set up repayment plans).

vehicle that compels repayment but, instead, the cost of purchasing a replacement.[142]

The fact that 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 pay in title loan transactions.[143] 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?" We provided various categories of bills. 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 that 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 that 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

142. *See* NCLC Webinar, *supra* note 48 (remarks of Jay Speer).

143. *See id.* (asserting that some lenders in Virginia, like Advance America, do title loans with a second lien on the vehicle to make borrowers think the lender can take the car and sell it, even though Virginia law does not allow lenders to take a second lien on a vehicle).

of transportation. This issue is important because, if title 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.[144] Academic papers[145] and press reports[146] have also taken up the theme, reporting the argument that title loans are "more

144. *See, e.g.*, *Payday and Title Loans*, *Hearing Before the Illinois Senate Fin. Comm.* (1999) (statement of Daniel A. Edelman, on behalf of the Illinois Consumer Justice Council), *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.'"); NCLC Webinar, *supra* note 48 (remarks of Jessica Hiemenz) (noting the main concern with auto title lending is the risk of repossession); Barry Yeoman, *Sudden Debt?*, AARP THE MAGAZINE, Sep./Oct. 2006, at 129 ("They're really devastating for elderly people who need their cars."); *Loans Secured by Car Titles Trap Borrowers in Cycle of Debt*, CONSUMER AFFAIRS (Apr. 18, 2005), http://www.consumeraffairs.com/news04/2005/car_loans.html (last visited Apr. 8, 2012) (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") (on file with the Washington and Lee Law Review).

145. *See, e.g.*, Fox, *supra* note 104, at 140 (noting the risk to "vital transportation"); Braucher, *supra* note 137, at 332 (pointing out that title loans expose borrowers to "the risk of losing a car used to get to work"); Barr, *supra* note 8, at 166 ("With title lending . . . 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.").

146. *See, e.g.*, Elinat Paz-Frankel, *Opponents of Auto Title Lending Industry Hope Legislature Limits 'Outrageous' Fees*, MEMPHIS BUS. J., Aug. 22, 2008 (noting that "[c]ars are used as collateral for title loans" and that "when vehicles are repossessed, borrowers often are left with no means of driving to work"); Kirchhoff, *supra* note 122 ("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*, *supra* note 103 ("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.").

damaging than payday loans because borrowers who cannot pay the required fees lose their transportation to and from work."[147]

Most importantly, government officials have placed tremendous stock in the argument that people will lose their only way to get to work. One Congressman asserted that repossessions by title lenders "often" result in the loss of a job.[148] The House of Representatives itself passed a resolution calling on states to intervene in title lending markets because "title loans and title pawns 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 . . . ."[149] 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."[150] 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."[151]

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

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147. JEFF PETERSON, ARIZ. RURAL POLICY INST., PREDATORY LENDING: PROFILE AND ANALYSIS 5 (2007); *see also* Frank Burt et al., *Refund Anticipation, Payday, and Auto Title Loans: A Survey of Select Fringe Lending Products*, JORDEN BURT LLP, May 2006, at 21, *available at* http://www.jordenburt.com/attachments/489.pdf ("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.").

148. 146 CONG. REC. 12,524 (2000) ("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.").

149. H.R. Con. Res. 312, 106th Cong., 146 CONG. REC. 12,523 (2000) (enacted).

150. DOD REPORT, *supra* note 140, 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.").

151. Wisconsin Auto Title Loans, Inc. v. Jones, 714 N.W.2d 155, 179 (Wis. 2006) (Butler, J., concurring).

members to maintain employment."[152] 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."[153] The most common regulatory response, as demonstrated in the cases of Wisconsin and New Hampshire, is to ban title lending. In 2009, a Wisconsin state legislator supported a ban on title lending because "most folks need that car for work, family, etc."[154]

Yet, despite the frequency of this claim, 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 that we have no information about what vehicles people use to get to work.[155] 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."[156] However, TitleMax has only released the conclusions of its survey, not any of the underlying methodology or data. Thus, this central question of title lending policy remains entirely unaddressed.[157]

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152. Lynch Press Release, *supra* note 72.

153. *Doyle's Veto Pen Is a Sword for Consumers*, CAPITAL TIMES (Madison, Wis.), 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, 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.'").

154. Press Release, *Zepnick Proposes Consumer Lending Reforms*, WIS. POLIT., July 24, 2009, *available at* http://www.wispolitics.com/1006/090305_Payday_Lending.pdf.

155. *See, e.g.*, NCLC Webinar, *supra* note 48 (remarks of Leslie Parrish).

156. TMX Finance, *supra* note 11, at 43.

157. Another important policy question that needs research is whether most of the cars that lenders repossess actually work. Title lenders claim that most vehicles they repossess are essentially worthless. *See, e.g.*, Davis & Davis Interview, *supra* note 24 (estimating 90% of the vehicles TDJ Financial repossesses are worthless); Zywicki, *supra* note 3, at 455 ("[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 122 ("[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

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 two vehicles. If these results were representative—I do not suggest they are—and the repossession rates presented in Part II.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 doubt on the oft-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.

III. Title Lending Law

Several well-known federal laws govern title lending. One is the Truth in Lending Act, which, among other things, requires that title lenders disclose the cost of loans as an APR.[158] Another is the Talent-Nelson Amendment, which essentially forbids title loans to members of the armed service.[159] More recently, 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 the Bureau of Consumer Financial Protection to develop regulations for title lenders.[160]

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most do not, the claim that people are losing a means of transportation is obviously false. But it is hard to believe that lenders would spend the money to repossess nonfunctioning cars, suggesting people *are* losing a means of transportation.

158. 15 U.S.C. § 1664 (2006).

159. 10 U.S.C. § 987 (2006).

160. Consumer Financial Protection (Dodd-Frank) Act of 2010 § 1036, Pub. L. No. 111-203, 124 Stat. 2010 (to be codified at 12 U.S.C. § 5536). For a more extensive discussion of the importance of the Act for fringe creditors, see Jim Hawkins, *The Federal Government in the Fringe Economy*, 15 CHAP. L. REV. 23 (2011).

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 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.

Creating categories of different state regulations is significant because, while other articles have discussed title lending law generally,[161] 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 IV, which evaluates these different approaches.

A. Effective Bans

Although federal legislation has been introduced in an attempt to ban title loans across the nation,[162] it is difficult to find any states that explicitly ban title lending. However, 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.[163] Alaska has a small loan law that applies for any loan under $25,000.[164] The statute caps loans under $25,000 at a maximum of 3% a month,[165] which works out to roughly 42.5% APR. No statute in Alaska

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161. *See* Zywicki, *supra* note 3, at 434–35 (summarizing state laws at a high level); Martin & Adams, *supra* note 3, at 54–56 (discussing several individual state statutes without placing them into a broad conceptual framework).

162. A federal ban on auto title lending was introduced by Arizona Congresswoman Gabrielle Giffords. *See* Press Release, Rep. Gabrielle Giffords, *U.S. Rep. Gabrielle Giffords Acts to Ban Payday Lending Nationwide* (June 30, 2010), *available at* http://www.votesmart.org/public-statement/526382/us-rep-gabrielle-giffords-acts-to-ban-payday-lending-nationwide. The text of the bill is available at http://www.govtrack.us/congress/billtext.xpd?bill=h111-5689.

163. For a few other examples, see COLO. REV. STAT. § 5-2-201(2)(a)(I) (2010) (capping loans under $1,000 at 36% APR); VT. STAT. ANN., tit. 9, § 41a(b)(4) (West 2011) (capping loans secured by vehicles at 20% APR).

164. ALASKA STAT. §§ 06.20.010–.920 (2010).

165. *Id.* § 06.20.230(a).

explicitly exempts title lenders from this cap,[166] and Alaska does not allow title lenders to offer title loans structured as open-ended credit agreements to evade the cap.[167] Thus, if a business wants to make a title loan, it is subject to the 42.5% APR cap.

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 the federal government caps the interest rate on such loans at 36%.[168] 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.[169] One consumer advocate has found that title lenders will generally only operate if they are permitted to charge above 200% APR.[170] Thus, when states enact caps at lower amounts, the effect is a complete ban.[171]

166. 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.").

167. *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.").

168. *See* EZCORP, Inc., *supra* note 31, 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 . . . because it is not economically feasible for us to do so at these rates.").

169. 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 3, at 432 n.17.

170. *See* NCLC Webinar, *supra* note 48 (remarks of Leslie Parrish).

171. Indeed, a consumer advocate recently pointed out that one of the best ways to ban title lending is to place a cap on interest rates. *See id.* (remarks of Jay Speer).

B. Title Lenders Operating in States with Strict Price Controls

Despite the fact that 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%.[172] The Scorecard reports that thirty states fall within this category and should therefore have no title lenders.[173] Twenty states permit rates above 36%, but only seventeen permit rates above 200%,[174] the rate generally required to allow title lending to exist.[175] Yet, the American Association of Responsible Auto Lenders reports that its members alone operate in twenty-two states,[176] 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 fail to do so because title lenders use creative legal moves to avoid the rate cap. Lenders have avoided 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 their creative practice.

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172. *See* LEAH A. PUCKETT ET AL., NAT'L CONSUMER LAW CTR., SMALL DOLLAR LOAN PRODUCTS SCORECARD—UPDATED 14–20 (May 2010), *available at* http://www.nclc.org/images/pdf/high_cost_small_loans/payday_loans/cu-small-dollar-scorecard-2010.pdf.

173. *Id.* at 14–20.

174. *Id.*

175. *See* NCLC Webinar, *supra* note 48 (remarks of Leslie Parrish).

176. Am. Assoc. of Responsible Auto Lenders, *About the AARAL*, http://www.responsibleautolenders.org/about/ (last visited Jan. 10, 2012).

1. Open-Ended Credit

Kansas is a state with a 36% interest rate cap,[177] but it has active title lending within its borders.[178] To avoid the cap and operate within Kansas, lenders structure title loans in Kansas as open-ended credit arrangements. In an open-ended credit plan, like those used by credit card companies, 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.[179] 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 . . . ."[180]

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 . . . ."[181] 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[182] had a similar loophole that resulted in title lenders offering open-ended credit plans.[183]

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177. *See* KAN. STAT. ANN. § 16a-2-401(2) (2009)

> 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 . . . .

178. *See, e.g.*, Speedy Cash, *Kansas Store Locations*, http://www.speedycash.com/payday-loans/kansas/locations/ (last visited Apr. 8, 2012) (on file with the Washington and Lee Law Review); Speedy Cash, *Auto Equity Loans*, http://www.speedycash.com/auto-equity-loans/ (last visited Apr. 8, 2012) (on file with the Washington and Lee Law Review).

179. For a legal definition, see Truth in Lending Act of 1968, 15 U.S.C. § 1602(i) (2006); 12 C.F.R. § 226.2(a)(20) (2010).

180. Speedy Cash, *Auto Equity Loans*, http://www.speedycash.com/auto-equity-loans/ (last visited Apr. 8, 2012) (on file with the Washington and Lee Law Review).

181. KAN. STAT. ANN. § 16a-2-401(1) (2009).

182. VA. CODE ANN. tit. 15-2, subtit. II, ch. 26 (West 2011).

183. *See Attorney General Files Lawsuit Against Local Auto Title Dealer*,

Similarly, reports indicate lenders in Iowa operated this way as well.[184] Finally, lenders hoping to avoid the 36% rate cap on loans to military personnel are now offering open-ended "payday advances."[185]

2. Credit Service Organizations

Title lenders operating in Texas face a similar interest rate cap of 30% for loans under $1,800.[186] Instead of offering loans directly to borrowers and thus being subject to this cap, most lenders operate as Credit Service Organizations (CSOs). A CSO is 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.[187] The statute does not limit the fees a CSO can charge for these services.[188]

The purpose of this CSO statute was to protect consumers from fraud when they employ credit repair organizations to fix distressed credit.[189] 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

DAILY PRESS (Hampton Roads, Va.), May 19, 2010, *available at* http://articles.dailypress.com/2010-05-19/news/dp-nws-cash-lawsuit-20100518_1_open-end-credit-loans-subject-borrowers (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).

184. *See, e.g.*, Kirchhoff, *supra* note 122.

185. *See DoD Shares Loan Blame*, AIR FORCE TIMES, Apr. 26, 2010, at 4 ("But blame the Pentagon [for] limiting the law's protections to just . . . 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.").

186. TEX. FIN. CODE ANN. § 342.201 (West 2009).

187. *Id.* § 393.001.

188. *Id.* §§ 393.001–.628.

189. *See* 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, 56 (2003) (reporting that states enacted CSO statutes to regulate entities that attempt to improve a consumer's credit rating).

consumer credit by another for the consumer.[190] The Attorney General of Texas[191] and the Fifth Circuit[192] have both opined that companies acting as CSOs are not bound by state usury limits on loan fees.

EZCORP's Annual Report summarizes how EZCORP generates fees as a CSO:

> 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 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.[193]

The Texas legislature recently changed the CSO law to specifically address title lenders and payday lenders who operate as CSOs,[194] but for years, the CSO model of operation allowed lenders in Texas to operate with few substantive restrictions in a state with a strict usury law.

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

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190. TEX. FIN. CODE ANN. § 393.001(3) (West 2009).

191. *See* 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) (on file with the Washington and Lee Law Review).

192. *See* Lovick v. Ritemoney, Ltd., 378 F.3d 433, 442–43 (5th Cir. 2004).

193. EZCORP, Inc., *supra* note 31, at 6; *see also* Mary Spector, *Taming the Beast: Payday Loans, Regulatory Efforts, and Unintended Consequences*, 57 DEPAUL L. REV. 961, 983–95 (2008).

194. *See* H.B. 2592, 82nd Leg., Reg. Sess. (Tex. 2011) (requiring payday and title lenders to make certain disclosures); *see also* H.B. 2594, 82nd Leg., Reg. Sess. (Tex. 2011) (requiring payday and title lenders to be licensed by the state).

are capped at 2.5%, but loans over $2,500 are not covered by the cap.[195] Thus, title lenders offer loans for $2,501 at any rate they agree on with the borrower.[196]

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 over 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 or 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.[197] The

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195. CAL. FIN. CODE § 22303 (2009).

196. *See* Fast Auto & Payday Loans, *Fast Auto and Payday Loans, Inc. Is Helping People Just Like You Get the Extra Cash You Need*, http://www.clacal.com/ (last visited Apr. 8, 2012) ("Need a California title loan? $2,501 to $10,000 Available Now!") (on file with the Washington and Lee Law Review). Similarly, in Illinois, title lenders began offering sixty-one-day loans when the legislature attempted to regulate title loans by passing a statute covering loans under sixty days. *See* Stephen Franklin, *Loophole Lets Lender Skirt Law, Group Says*, CHI. TRIB., Apr. 25, 2008, at B1, *available at* http://articles.chicagotribune.com/2008-04-25/business/0804241039_1_payday-loans-cash-strapped-borrowers-annual-interest (suggesting that circumvention of loan term limits is "not new" to Illinois lenders).

197. ARIZ. REV. STAT. ANN. § 44-281(13) (2010). The statute governs "secondary motor vehicle finance transactions." The definition in the statute reveals that it regulates title lending because it includes 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.

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 loans over $5,000.[198] Otherwise, the U.C.C. governs these loans as secured transactions.[199]

Other states authorize title lending in a slightly less direct form by simply authorizing small loans, which capture almost all title loans, but not placing any restrictions on the interest rate for these loans. New Mexico, as an example, authorizes small-dollar loans through a specific statute,[200] and even makes it a violation of the small-loan statute to charge a usurious rate based on other state law.[201] However, the small-loan statute does not have a usury cap,[202] and the state does not have a general usury cap.[203] The only provisions governing title loans are the generic ones in the U.C.C.

> (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.

Id.

198. *Id.* § 44-291(G).

199. *See generally* U.C.C. art. 9 (1977).

200. N.M. STAT. ANN. §§ 58-15-1 to -39 (2010).

201. *Id.* § 58-15-23.

202. *See id.* §§ 58-15-1 to -39.

203. Section 56-8-3 states 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 to one in a written contract. In a similar context, the New Mexico Supreme Court has held that a statute like this one does not cap interest rates. *See* Superior Concrete Pumping Inc. v. David Montoya Constr., Inc., 773 P.2d 346, 348–49 (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).

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.[204]

On the opposite end of the spectrum, Maine specifically states that title lending is not within the pawn-brokering statute. The items covered by Maine's pawn law include "motor vehicles, but do[] not include documents evidencing title to motor vehicles."[205] Similarly, Louisiana limits 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."[206]

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."[207] Yet, the Alabama Supreme Court has ruled

204. GA. CODE ANN. § 44-12-130(5) (2010).

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

206. LA. REV. STAT. ANN. § 37:1801(D) (2010).

207. ALA. CODE § 5-19A-2(3) (2010).

that a certificate of title held by a lender counts as a "pledged good," making title loans subject to pawn transaction rules.[208]

The courts have provided certainty that Alabama's pawn laws apply to title lenders, but this finding is unique among the states that have similarly vague definitions of pawned goods. Other courts have found title lenders are violating usury statutes by guessing incorrectly that title loans are governed by pawnshop laws.[209]

When title loans are governed by pawn laws, a series of common provisions usually apply:[210] the law forbids lenders from seeking deficiencies and does not require them to pay surpluses;[211] loan terms are set at thirty days;[212] interest rates are sometimes capped, but the cap is set at a high amount;[213] and lenders must wait for a set period after default before they may sell the collateral.[214]

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

209. 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.

210. Carrie Teegardin, *Title Loan's Price High*, ATLANTA JOURNAL-CONSTITUTION, Jan. 25, 2009, *available at* http://www.ajc.com/ajccars/content/printedition/2009/01/25/titlepawn0125.html ("[T]he 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 . . . . Lenders can sell repossessed cars and retain the entire proceeds . . . even if those far exceed the balance on the loan.").

211. *See, e.g.*, ALA. CODE § 5-19A-6 (2011).

212. *See, e.g.*, GA. CODE ANN. § 44-12-131(a)(1) (2011).

213. *See, e.g.*, ALA. CODE § 5-19A-7(a) (2011) (setting a 25% per month interest rate cap); GA. CODE ANN. § 44-12-131(a)(4)(A) (2011) (same).

214. *See, e.g.*, ALA. CODE § 5-19A-5(c) (2011) ("All goods purchased by the pawnbroker except for automobiles, trucks, and similar vehicles shall be maintained on the premises . . . 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) ("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

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.[215] 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-leaseback agreements,[216] 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."[217] Finally, the statute outlines the charges a lender can levy if it takes possession of a vehicle[218] and requires lenders to disclose these charges to borrowers.[219] 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 subpart outlines some of the common features of these laws, although individual states may have only some of these requirements. In addition, this subpart 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.

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date . . . .").

215. Similarly, Minnesota governs title loans with its pawn laws supplemented by some additional provisions specific to title loans. *See* MINN. STAT. § 325J.095 (2011).

216. GA. CODE ANN. § 44-12-131(a)(2) (2011).

217. *Id.* § 44-12-131(a)(3).

218. *Id.* § 44-12-131(a)(4)(C).

219. *Id.* §§ 44-12-138(3),(12)–(15).

1. Licensing Requirements

A primary form of direct regulation of title lenders is licensing requirements.[220] Tennessee's law, for instance, voids any title loan made by an entity that is not licensed by the state.[221] To obtain a license, a title lender must, among other requirements, (1) have net assets of $75,000 per location,[222] (2) pay an $800 filing fee per location,[223] (3) submit a balance sheet and income statement prepared by an unaffiliated certified public accountant,[224] and (4) obtain a surety bond of $25,000 per location (not to exceed $200,000 per firm).[225] In addition to requirements for obtaining a license, firms must report certain information to the state[226] and make their records available for examination.[227]

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.[228] Other states specifically limit the number of times a customer can roll over 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.[229] 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

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220. *See, e.g.*, DEL. CODE ANN. tit 5, § 2202 (2011); FLA. STAT. § 537.004 (2011); IDAHO CODE ANN. § 28-46-503 (2011).

221. TENN. CODE ANN. § 45-15-105 (2011).

222. *Id.* § 45-15-106(a)(1).

223. *Id.* § 45-15-106(d)(1).

224. *Id.* § 45-15-106(d)(2).

225. *Id.* § 45-15-106(d)(3).

226. *Id.* § 45-15-109.

227. *Id.* § 45-15-108.

228. *Id.* § 45-15-113(d).

229. DEL. CODE ANN. tit. 5, § 2254 (2011).

unpaid indebtedness beyond the originally stated repayment period."[230]

3. Repossessions

States regulating title loans directly often provide rules for lenders attempting to gain possession of vehicles if the borrower defaults. Like Georgia,[231] most states incorporate[232]—or at least do not displace[233]—U.C.C. Article 9's requirement that secured lenders not breach the peace while gaining possession of a vehicle.[234] Illinois goes a few steps farther, requiring lenders to notify borrowers of their intention to take possession, 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."[235] Other states forbid lenders from purchasing vehicles they have repossessed,[236] despite the normal rule in secured transactions that permits lenders to purchase goods they have repossessed subject to some restrictions.[237]

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230. *Id.* § 2202. 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).

231. *See supra* note 218 and accompanying text.

232. *See, e.g.*, DEL. CODE ANN. tit. 5, § 2259 (2011) ("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."); IDAHO CODE ANN. § 28-46-507(2) (2011) ("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."); ILL. ADMIN. CODE tit. 38, § 110.140 (2011) (stating that lenders must follow all applicable provisions of the U.C.C.).

233. *See, e.g.*, NEV. REV. STAT. § 604A.455(1) (2011).

234. U.C.C. § 9-609(b)(2) (1977).

235. ILL. ADM. CODE tit. 38, § 110.390(b) (2011).

236. IDAHO CODE ANN. § 28-46-508(6) (2011).

237. U.C.C. § 9-610(c) (1977).

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.[238] 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 of that motor vehicle as required by part 6 (Default) of Article 9 (Uniform Commercial Code—Secured Transactions) of Title 6.[239]

While some states permit lenders to seek payment if the borrower purposefully prevents the lender from repossessing the vehicle or damages the vehicle,[240] others, 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 a cap on the loan amount. 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.[241] A few cap the loans based on the value of

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238. *See, e.g.*, IDAHO CODE ANN. § 28-46-508(2) (2011) (prohibiting lender from seeking any deficiencies from borrower and requiring lender to pay surplus to borrower); MISS. CODE ANN. § 75-67-411(1), (5) (2011) (same); MONT. CODE ANN., §§ 31-1-816(2)(i),-818(8) (2011) (same); NEV. REV. STAT. § 604A.455(1) (2011) (same); S.C. CODE ANN. § 37-3-413(5) (2011) (same); TENN. CODE ANN. §§ 45-15-114(b)(2), 45-15-115(2) (2011) (same); UTAH CODE ANN. § 7-24-204 (2011) (same).

239. DEL. CODE ANN. tit. 5, § 2260 (2011).

240. *See* IDAHO CODE ANN. § 28-46-508(2) (2011) (forbidding deficiencies except "where the debtor prevented repossession of the vehicle, damaged or committed or permitted waste on the vehicle or committed fraud").

241. *See* ILL. ADM. CODE, tit. 38, § 110.370(a) (2011) (stating title loans cannot exceed $4,000); MISS. CODE ANN. § 75-67-415(f) (2011) (forbidding title

the vehicle, sometimes providing appraisal guides as a measuring tool.[242] 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.[243]

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."[244] Some statutes make clear that determining the consumer's ability to repay the loan does not require a formal credit check but can instead rely on the consumer's reported income and obligations.[245] Illinois's statute is more simplistic and easy to apply, prohibiting any loans

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loans over $2,500); MO. REV. STAT. § 367.527(2) (2011) (prohibiting title loans over $5,000); TENN. CODE ANN. § 45-15-115 (3) (2011) (limiting title loans to $2,500).

242. *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) (2011); NEV. REV. STAT. ANN. § 604A.450(1) (2010).

243. S.C. CODE ANN. § 37-3-413(4) (2011).

244. NEV. REV. STAT. ANN. § 604A.450(2) (2011); *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."); S.C. CODE ANN. § 37-3-413(3) (2011) ("Before making a short-term vehicle secured loan, a lender shall form a good faith belief that the borrower has the ability to repay the loan, considering [various factors]."); UTAH CODE ANN. § 7-24-202(3)(d) (2011) ("[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.").

245. S.C. CODE ANN. § 37-3-413(3) (2011) (stating the lender may comply by having the borrower sign a statement on a separate form "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"); UTAH CODE ANN. § 7-24-202(4) (2011) (stating that the requirement is met if the borrower "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").

that have a single payment that "exceeds 50% of the obligor's gross monthly income."[246]

6. Restrictions on Fees

Many states that directly regulate title lending set limits on the interest rates and other fees that lenders can charge.[247] These interest rate caps vary from 18%[248] or 30% per year[249] to around 206% a year[250] or 304% a year.[251] 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 checks[252] and the cost of recording a lien.[253]

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

IV. Evaluating Title Lending Laws

In light of the different regulatory models discussed in Part III, 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 other end of the spectrum, states that authorize title lending without any restrictions or regulate title lending as pawn

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246. ILL. ADM. CODE tit. 38, §110.340(a) (2011).

247. Of course, some states, like Delaware, have no interest rate limits. *See* DEL. CODE ANN. tit. 5, §§ 2250–2261 (2011).

248. *See* VT. STAT. ANN. tit. 9, § 41a(b)(4) (2011).

249. *See* FLA. STAT. § 537.011(1) (2011).

250. *See* ARIZ. REV. STAT. § 44-291(g) (2011).

251. *See* MISS. CODE ANN. § 75-67-413(1) (2011).

252. *See* OR. REV. STAT. § 725.615(2)(a) (2011) (limiting fees for dishonored checks to $20).

253. *See* MONT. CODE ANN. § 31-1-817(2) (2011) (limiting charges for recording a lien to the actual costs to the lender).

transactions offer too little regulation to ensure meaningful protections for customers. Finally, this Part makes the case for industry-specific regulation and suggests laws that are important for policymakers 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 II, we know title-loan borrowers experience a relatively low rate of repossession, and we have no evidence that those who do lose vehicles are losing 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 in 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 to reign in 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%.[254] Of those who do lose their vehicles, many likely do not lose a functioning mode of transportation,[255] so it is not clear that 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.[256]

For those who do lose their vehicle to repossession, we know that many lose the equity they have in the vehicle because a lender

254. *See supra* Table 2.
255. *See supra* note 157 and accompanying text.
256. *See supra* note 155 and accompanying text.

can charge the costs of repossessing, storing, and selling it. 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.[257] Moreover, this same problem of borrowers losing equity exists under Article 9 of the U.C.C., which also permits lenders to charge costs against the borrower.[258] Clearly then, the argument against title lending based solely on losses from repossession fees proves too much. At the very least, policymakers who have relied on repossession rates and academics' fears that borrowers are losing their only vehicles should reconsider these positions in light of the new reports state regulators are generating, as well as the fact that no studies have demonstrated that people are losing 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 surveys by the FDIC and a major title lender, some borrowers are using title loans to meet short-term emergency liquidity crises, and others use title loans to finance small business operations.[259] 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 will be denied access to credit altogether.[260] The title lender survey I was provided seems to substantiate this view, as shown in Table 4.

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257. *See supra* Part II.B.2.b.

258. *See* U.C.C. § 9-615(a)(1) (1977) (specifying that proceeds of sale of repossessed items are to be applied first to "reasonable expenses of retaking, holding, preparing for disposition, processing, and disposing" of the collateral).

259. *See supra* Table 1 (listing factors motivating borrowers to take out title loans).

260. Zywicki, *supra* note 3, at 427 ("If deprived access to title loans, many consumers would substitute less-preferred sources of credit or risk losing access to legal credit altogether.").

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.[261] Table 5 summarizes these 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%
Sell car	3	8.57%
Not borrow and do without loan	18	51.43%
No answer	3	8.57%

If later research were to show that these results are representative of title lending customers, they suggest that, for many customers, title lending is not an essential source of credit that will necessarily be replaced by an inferior choice. The survey does not reveal, however, what costs go along with forgoing a loan. But, if borrowers can avoid using loans, 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 serve for small businesses and should exempt businesses from the ban. Existing state and

261. 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. I suggest future surveys always include "choose not to borrow" as an option for a question about alternatives to title lending.

federal statutes can act as examples of how to restrict only consumer uses of title loans. The Fair Debt Collection Practices Act,[262] for instance, only applies to consumer debt.[263] 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.[264] Even those supporters of a ban on non-productive or abusive consumer uses for title loans should support productive business uses of the transaction. A ban on title loans could easily 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 stating the simple argument that title loans are too expensive. For example, the argument that people roll their loans over 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 that an inexpensive form of this

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262. Fair Debt Collection Practices Act, Pub. L. No. 90-321, 91 Stat. 874 (1977).

263. *See* 15 U.S.C. § 1692a(5) (2006) ("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."). Similarly, Texas's Deceptive Trade Practices Act defines "consumers" under the Act and exempts large businesses. *See* TEX. BUS. & COM. CODE § 17.45(4) (2011):

> "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.

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

transaction is possible for the clientele currently served by title lenders, so banning is the only option to deal with this 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 Versus 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 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, laws that are not tailored to the title-lending transaction leave customers vulnerable to harm.

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,[265] and in those states, firms operate with confidence.[266]

In states without case law holding that 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

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

266. *See* Don Baylor, Op-Ed, *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.").

began offering loans in Virginia.[267] 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.[268]

Stock prices can reflect the deleterious effect of uncertainty on alternative financial service providers. Gary Rivlin describes the effects uncertainty had on the stock of Advance America, a large payday lender, when multiple bills in Congress and numerous states were 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."[269] This sort of uncertainty likely 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, because they 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 suit if it, for instance, wrongfully repossesses and sells a borrower's vehicle. Thus, because uncertainty decreases the number of companies willing to do business in a state and may also result in lower-quality companies operating there, states should enact title-loan specific laws.

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267. *See* TMX Finance, *supra* note 11, 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.

268. *See* NCLC Webinar, *supra* note 48 (remarks of Jay Speer).

269. GARY RIVLIN, BROKE, USA: FROM PAWNSHOPS TO POVERTY, INC.—HOW THE WORKING POOR BECAME BIG BUSINESS 313–14 (2010).

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 U.C.C. applies to title loans as secured transactions, empowering lenders to sue borrowers for deficiency judgments. As Part II.B.2.b. argues, 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 specifically tailored laws.

A potentially powerful counter-argument against 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,[270] 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. Some title loans are oversecured, as demonstrated by the $251,047 lenders returned to borrowers in Tennessee in 2008,[271] for instance. Thus, the pawn laws' failure to require surplus payments fails to protect a specific segment of title lending customers.

C. Specific Features Legislators Should Consider

Instead of banning title lending or requiring lenders to fit within existing credit laws, states should enact provisions

270. *See* Martin & Adams, *supra* note 3, at 78 (stating that all title loan contracts the authors reviewed allowed the lender to sue for deficiencies).

271. 2010 TENN. REPORT, *supra* note 38, at 8.

specifically tailored to title lending. This section outlines my tentative suggestions 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 make disclosures aimed at overcoming customers' overly optimistic assessments of the transactional risks. Also, it is important that 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. In the real estate context, the purpose of anti-deficiency statutes is "to prevent the aggravation of an economic recession which would result if creditors lost their property and were also burdened with personal liability . . . ."[272] Similarly, in this context, states should limit liability for those customers who likely have the most to lose.

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 ensure that borrowers do not default and leave 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 inclined to make less risky loans.

Finally, allowing lenders to pursue deficiencies may push consumers to stay in disadvantageous title loans for longer than they should. For some borrowers, defaulting on the title loan is a better outcome than continuing to pay high interest rates month after month. The cost of losing one's car might be lower than the cost of keeping it. Allowing the lender to obtain a personal

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272. 4 MILLER & STARR, CAL. REAL EST. § 10:214 (3d ed. 2011).

judgment against the borrower, however, decreases the likelihood the borrower will opt to default. As Andra C. Ghent and Marianna Kudlyak have demonstrated in the context of mortgages: "[A]llowing the lender recourse to assets other than the mortgaged property lowers the value of the default option and thus reduces the borrower's incentive to default."[273]

The negative consequence from 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.[274] Requiring lenders to return any surplus from selling the vehicle mitigates the effect of smaller loans to some extent; thus, it is an important companion law (assuming U.C.C. Article 9's analogous provision is displaced by the title lending law). If lenders have to return surpluses, borrowers will at least be protected to the extent their equity exceeds the costs of repossession. As Part II.B.2 makes clear, however, this protection is still minimal, so borrowers will suffer in states that forbid deficiencies by getting lower loan amounts. However, on balance, the prohibition's protections probably outweigh the harms.

One legislator has expressed concern over the requirement that lenders return surpluses because lenders are not protected when vehicles are not worth anything after repossession.[275] The losses a lender might face, however, are adequately accounted for in the high interest rate on these loans, so requiring surpluses is

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273. Andra C. Ghent & Marianna Kudlyak, *Recourse and Residential Mortgage Default: Theory and Evidence from U.S. States* 1 (Fed. Reserve Bank of Richmond, Working Paper No. 09-10, 2009), *available at* http://www.richmondfed.org/publications/research/working_papers/2009/pdf/wp09-10r.pdf.

274. *See* MILLER & STARR, *supra* note 272, § 10:214 (noting one purpose of anti-deficiency statutes is "to prevent an overvaluation of the security").

275. *See Title Pawn Industry Warns Legislation Could Hurt the Poor*, ACCESS NORTH GEORGIA (Oct. 25, 2005), http://new.accessnorthga.com/detail.php?n=136791&c=2 (last visited Apr. 8, 2012).

> 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?"

(on file with the Washington and Lee Law Review).

not necessary to balance lenders' losses. Moreover, it is unlikely that title lenders would exit a state simply due to a requirement that they return surpluses because some of the largest lenders already return surpluses even though not required by law.[276] In a study of pawnbrokers, John Caskey found requiring pawnbrokers to turn over the surplus did not affect the number of pawnshops per million residents.[277]

2. Disclosures Aimed at Optimism and Cost

My limited survey found that the people we surveyed were overly optimistic about the risks that they would either roll their loans over multiple times or 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."[278] Similar measures could be tested or adopted for title-lending laws. Generally, firms tolerate disclosure requirements well,[279] so they are 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 25% of the borrowers recognized that title loans were a lot more expensive than credit cards.[280] 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

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276. *See id.* (reporting TitleMax returns surpluses to customers in Georgia even though the law does not require it).

277. *See* Prager, *supra* note 90, at 11 (discussing Caskey's study).

278. Marianne Bertrand & Adair Morse, *Information Disclosure, Cognitive Biases and Payday Borrowing* 1 (Univ. Chi. Booth Sch. of Bus., Working Paper No. 10-01, 2009), *available at* http://ssrn.com/abstract=1532213.

279. *See* Anonymous Interview, *supra* note 24, at 10 ("Industry best practices include additional, prominent disclosures that go beyond most state and federal requirements . . . .").

280. *See supra* note 90 and accompanying text.

term of a consumer contract, and the price is so high for title loans, requiring clear disclosures seems appropriate.

The best disclosures would show the cost of borrowing per \$100 borrowed, displayed on the windows of the store to foster price competition. Rules about stating loan cost as an APR[281] should be vigorously enforced because lenders should be able to train staff to discuss APRs. Because most title loans are for one-month terms, it should be easier for title lenders to correctly calculate the APR on a title loan than it is for payday lenders, whose loan terms depend on the length of time until the borrower's next payday.[282] Since lenders appear to already compete for customers based on price,[283] 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.[284] 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, amortizing loan. Unlike the traditional title loan that 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.

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281. *See* Regulation Z, 12 C.F.R. §§ 226.17–226.18 (2012) (setting out Truth in Lending Act requirements for APR disclosures in consumer loans).

282. *See* Mann & Hawkins, *supra* note 230, at 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 obtains the loan, when actually the cost is uniform throughout that cycle. This confusion does nothing to help consumers evaluate competing products.

283. *See supra* notes 94–101 and accompanying text.

284. *See, e.g.*, GA. CODE ANN. § 44-12-131(a) (2011) (limiting title loans to thirty-day terms).

Cash America, a large public company, has a product that exemplifies this approach. The company offers twelve- to twenty-four-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.[285] The cost of Cash America's product is less than for normal title loans, closer to 110% APR.[286] The company's goal in creating this product was to reach a different demographic than the typical title loan consumer—customers more like mainstream borrowers who want a product more closely resembling a traditional loan.[287]

Additionally, several smaller companies in Houston offer amortizing title loans with longer terms, but unlike Cash America, they do not do formal credit checks.[288] Texas Title Loans, as one example, advertises:

> 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![289]

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285. Vaugh & Bourns Interview, *supra* note 52, at 2.

286. *Id.* at 4.

287. *Id.*

288. *Are You Trapped in a 30-Day Loan?*, THE LOAN DEPOT (Oct. 11, 2010, 10:10 AM), http://www.yourloandepot.com/blog_entries/ai/Corporate-5/are-you-trapped -in-a-30-day-loan.html (last visited Apr. 8, 2012) ("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!!") (on file with the Washington and Lee Law Review); Advantage Finance, LLC, *Frequently Asked Questions—What is a Car Title Loan?*, http://www.cartitleloanshouston.com/pages/faqs.html (last visited Apr. 8, 2012)

> 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.

(on file with the Washington and Lee Law Review).

289. Texas Title Loans, *Welcome to Texas Title Loans!* (June 29, 2011), http://txtitleloans.net/ (last visited Apr. 8, 2012) (on file with the Washington

Another lender, TJD Financial Services, offers amortizing loans for the specific purpose of keeping people out of the trap created by large balloon payments.[290] Finally, one other small operator in Houston offers customers the choice of a traditional title loan or an installment plan.[291]

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).[292]

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's value possible because then borrowers who lose a vehicle will lose the least amount of their equity. Loan caps put the risk of repossession on borrowers because they will

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and Lee Law Review).

290. *See* Davis & Davis Interview, *supra* note 24, at 1.

291. *See* Magnolia Loans, *Title Loans*, http://www.magnolia-loans.com/our-services/loan-services/title-loans/ (last visited Apr. 8, 2012)

> Your title loan can be structured to fit your preference. If you need a cash advance for a short period of 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.

(on file with the Washington and Lee Law Review). For an example of a smaller company in Arizona that offers a choice between a balloon product and an amortizing product, see Cash-N-Go, *Title Loans, How It Works*, http://www.azcashngo.com/vehicle-title-loans-online-how-works.php (last visited Apr. 8, 2012) (on file with the Washington and Lee Law Review).

292. *See supra* notes 243–45 and accompanying text.

walk away from a repossession with no vehicle, less money from the loan, and probably no surplus because the equity cushion is likely consumed by repossession costs.[293]

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.[294] At best, loan caps protect wealthier title-loan 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.[295] Yet, loan caps based on dollar amounts are an inapt means of dealing with this problem. They only address mismatches at high levels of income, while exhibiting no concern for people who take out smaller loans (e.g., $2,000) but lack the means of repaying them. 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.

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293. *See supra* note 70 and accompanying text. 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.

294. *See, e.g.*, Anonymous Interview, *supra* note 24, at 9 (stating that Anonymous "believe[s] the consumer is in the best position to make th[e] decision" about the loan amount, so long as the amount does not exceed equity in the vehicle).

295. *See supra* note 71 and accompanying text.

5. Caps on Prices

Some states cap the cost of loans,[296] and high interest rates are a concern to members of Congress.[297] 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 less likely in title lending because the loans are "very simple and very transparent loans with a small number of terms."[298]

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 worse off from title loans, so policymakers should avoid setting price terms which may decrease loan amounts.

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296. *See supra* notes 247–53 (listing states with interest rate and fee restrictions).

297. *See, e.g.*, 155 CONG. REC. S5346-01 (daily ed. May 12, 2009) (statement of Sen. 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.

See also 146 CONG. REC. H5179-02 (daily ed. June 27, 2000) (statement of Rep. Roukema) ("Abuses in title loans and title pawn transactions often include excessively high interest rates and other exploitive lending practices.").

298. Zywicki, *supra* note 3, at 430.

V. 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 roll over 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.

It is clear that 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. 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.

Appendix A

Survey on Auto Title Lending
Contact: Asst. Professor Jim Hawkins, 713-743-5018

<u>Please circle your answer:</u>

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:
____