

# POLICY INNOVATION: CURBING PREDATORY CAR TITLE LENDING<sup>1</sup>

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## OVERVIEW

Vehicles are important assets for individuals and families; they are critical for transportation to work, school and child care. Although vehicles traditionally depreciate over time and thus are not permanent assets, losing a vehicle is nonetheless devastating for households' economic well-being. Unfortunately, through a new predatory lending product – often referred to as a “motor vehicle equity line of credit” – repossession of a vehicle is a very real threat. Motor vehicle equity lines of credit provide small dollar loans to borrowers. They are similar to predatory payday loans, but instead of securing the financing with the borrower's signed personal check, they use the borrower's vehicle as collateral.

As with predatory payday loans, lenders often target those with bad credit or those who are low-income, elderly or members of the military. They market these loans using misleading names such as “car title loans,” “sales with leasebacks” or “pawns.” Lenders market motor vehicle equity lines of credit as a way to help borrowers get through emergency situations, such as a health crisis or unemployment. However, these loans are risky because of their short repayment time frames (usually 30 days) and their high interest rates – averaging 300% Annual Percentage Rate (APR). The short repayment time frame means borrowers often have difficulty paying back the loans. As a result, they “roll over” the loan to extend the payment schedule, which increases the total amount of money owed. Borrowers end up deeper in debt and are eventually stripped of their vehicles.

## WHAT STATES CAN DO<sup>2</sup>

The most valuable action states can take to protect consumers is to ban motor vehicle equity lines of credit or to effectively ban them by limiting the maximum APR lenders may charge. Short of that, states can take a number of steps including regulating loan terms and making those terms more transparent, setting a limit on the number of loans a consumer can take annually and expanding consumer protection laws. States also can invest in financial literacy programs for those who are likely to use “fringe” financial products and provide emergency funds to help families in crisis.

<sup>1</sup> Go to the Curbing Payday Lending section of <http://scorecard.cfed.org> for more information.

<sup>2</sup> In addition to protecting consumers from predatory motor vehicle equity lines of credit, states also should address predatory practices that occur when consumers purchase a vehicle. As with motor vehicle equity lines of credit, consumers risk losing vehicle equity – or losing their vehicle altogether – when securing financing for a vehicle. This policy brief does not attempt to address predatory automobile financing.

## ELEMENTS OF A STRONG POLICY

Based on the expertise of the Center for Responsible Lending and the Consumer Federation of America, CFED asserts that the strongest state policy is one that explicitly or effectively bans motor vehicle equity lines of credit. States can effectively eliminate the practice by limiting the APR borrowers may charge, thus reducing the profitability of the loans.

If banning motor vehicle equity lines of credit is not feasible, a state should adopt policies that protect consumers and empower them to make sound financial choices. These policies should:

- **Protect consumers.** States should ensure that borrowers maintain their right to judicial review and the right to renegotiate the terms of their loan prior to the repossession of their motor vehicle, even after defaulting on a payment. Additionally, states should limit the number of loans a borrower can take in a year and require better disclosures about the terms of a loan, including monthly interest rates and APR, orally and in writing.
- **Provide financial education.** States should invest in programs to increase financial literacy so that residents understand the risks and benefits of various financial products. Financial education can help people understand alternatives to these loans that have better terms, such as salary advances from an employer, short-term loans from a credit union or local- and state-sponsored emergency assistance programs.

## WHAT STATES HAVE DONE<sup>3</sup>

Nearly half the states have banned motor vehicle equity lines of credit. However, even in these states, loopholes in the laws are often exploited by lenders and should be reformed with additional legislation or regulation. In addition, at least 14 states have recently passed legislation supportive of auto title lenders.

Short of banning motor vehicle lines of credit, states have used a number tactics to regulate these loans including requiring licensure for lenders and stronger disclosure policies. For example, in Iowa, legislation passed in 2007 that strengthened disclosure requirements about rates, penalties and other fees, and also limited car title loans to 21% APR. Other states have banned lenders from making car title loans to members of the military and their families. Illinois introduced a comprehensive bill that would have required the amount of a loan be limited to 15% or less of the borrower's verified monthly gross income and allowed borrowers to make partial payments to a lender at any time without charge. Additionally, Illinois' bill would have capped interest rates at 36% APR and outlined disclosure requirements.

<sup>3</sup> Fox, J.A. (2005, November). *Driven into Debt: CFA Car Title Loan Store and Online Survey*. Washington, DC: Consumer Federation of America.

For more information, visit the Center for Responsible Lending at [www.responsiblelending.org](http://www.responsiblelending.org), the Consumers Union at [www.consumersunion.org](http://www.consumersunion.org), the Consumer Federation of America at [www.consumerfed.org](http://www.consumerfed.org) and the National Consumer Law Center at [www.consumerlaw.org](http://www.consumerlaw.org).

For more on the 2009-2010 Assets & Opportunity Scorecard – CFED's signature research on wealth, poverty and the financial security of American families – visit <http://scorecard.cfed.org>.