

Date of Hearing: April 2, 2018

ASSEMBLY COMMITTEE ON BANKING AND FINANCE

Monique Limón, Chair

AB 2953 (Limón) – As Amended March 19, 2018

SUBJECT: California Financing Law: consumer loans: title loans

SUMMARY: Prohibits a California Financing Law (CFL) licensee from charging more than 36% APR on a title loan.

Specifically, **this bill:**

1. Defines title loan as a nonpurchase money loan with a bona fide principal amount of \$2,500 or greater where the lender obtains a security interest in a motor vehicle.
2. Prohibits a CFL licensee from receiving charges under a title loan agreement in an amount greater than 3 percent per month on the unpaid principal balance of the title loan.

EXISTING LAW:

- 1) Provides for the CFL, administered by the Department of Business Oversight (DBO), which authorizes the licensure of finance lenders, who may make secured and unsecured consumer and commercial loans (Financial Code Sections 22000 et seq.). The following are the key rules applied to consumer loans made pursuant to the CFL:
 - a) CFL licensees who make consumer loans under \$2,500 are capped at interest rates which range from 12% to 30% per year, depending on the unpaid balance of the loan (Sections 22303 and 22304). In addition to the allowable interest charges, licensees may receive an administrative fee capped at the lesser of 5% of the principal amount of the loan or \$50 (Section 22305).
 - b) In addition to the requirements in “a” above, CFL licensees who make consumer loans under \$5,000 are prohibited from imposing compound interest or charges (Section 22309); are limited in the amount of delinquency fees they may impose (Section 22320.5; delinquency fees are capped at a maximum of \$10 on loans 10 days or more delinquent and \$15 on loans 15 days or more delinquent); are required to prominently display their schedule of charges to borrowers (Section 22325); are prohibited from splitting loans with other licensees (Section 22327); are prohibited from requiring real property collateral (Section 22330), and are limited to a maximum loan term of 60 months plus 15 days (Section 22334). For loans above \$2,500, administrative fees are capped at \$75 (Section 22305).
 - c) In addition to the requirements in “a” and “b” above, CFL licensees who make consumer loans under \$10,000 are limited in their ability to conduct other business activities on the premises where they make loans (Section 22154); must require loan payments to be paid in equal, periodic installments (Section 22307); and must meet certain standards before they may sell various types of insurance to the borrower (Sections 22313 and 22314).
 - d) Generally speaking, the terms of loans of \$10,000 or above are not restricted under the CFL.

- 2) Until January 1, 2023, authorizes the Pilot Program for Increased Access to Responsible Small Dollar Loans (Pilot) within the CFL (Financial Code Sections 22365 et seq.). The following are key rules applied to consumer loans made pursuant to the Pilot:
 - a) Permits approved licensees to make a loan with a bona fide principal amount of at least \$300, but less than \$2,500. Interest rates are capped at the lesser of 36% or 32.75% plus the prime rate for the unpaid principal balance up to \$1,000, and the lesser of 35% or 28.75% plus the prime rate for the unpaid principal balance in excess of \$1,000 (Section 22370(a) and (b)).
 - b) Provides that a licensee may charge an administrative fee in an amount not to exceed 7% of the principal amount, or \$90, whichever is less, on a first loan, and 6% of the principal amount, or \$75, whichever is less, on a second or subsequent loan. A licensee may not charge an underwriting fee more than once in any four-month period, and no administrative or underwriting fee may be charged in connection with a loan refinance unless at least eight months have elapsed, as specified (Section 22370(c)).
 - c) Requires a licensee to underwrite each loan and states that the licensee shall not make the loan if it determines that the borrower's total monthly debt service payments exceed 50% of the borrower's gross monthly income, as specified (Section 22370 (f)).
- 3) Imposes a 36% APR on consumer credit extended to members of the military and their dependents. (10 USC Sec. 987.)

FISCAL EFFECT: Unknown

COMMENTS:

1) **PURPOSE**

According to the author, the purpose of this bill is to provide a strong incentive for title lenders to conduct ability-to-pay underwriting. In 2016 20,648 vehicles were repossessed due to defaults on title loans compared to 108,080 total title loans originated, according to DBO's annual report on CFL licensees. For those consumers who avoided default, they often paid over 100% APR interest, effectively subsidizing the costly business models employed by title lenders. By establishing a 36% APR cap, lenders will be incentivized to improve underwriting standards upfront which will reduce the incidence of financial hardship caused by loan defaults and vehicle repossessions.

2) **BACKGROUND**

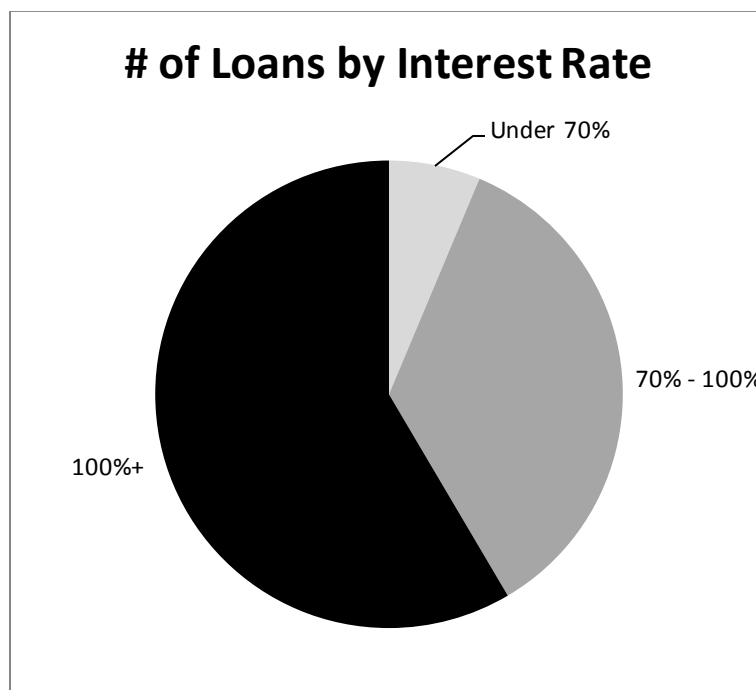
CFL lenders typically serve consumers who have limited credit options due to damaged credit history or minimal credit experience. These consumers often lack the option to obtain credit from banks and credit unions, so they rely on alternative financial service (AFS) providers (e.g., payday, title, and installment lenders) for their credit needs. Due to the higher credit risk of borrowers and less efficient business models of AFS providers relative to banks and credit unions, the interest rates and finance charges for AFS products are significantly higher than typical credit card rates, often exceeding 100% APR.

Title loans are a category of small dollar consumer loans (defined in this analysis as a consumer loan with a principal amount of less than \$10,000) under the CFL. DBO regulations describe a title loan as having “the characteristics of a short-term loan (typically 12 to 36 months) in which a borrower with clear title to his or her vehicle may immediately receive a loan secured by the borrower’s vehicle. These loans typically are more than \$2,500 and have a higher interest rate. The loans differ from traditional auto loans, which are financed and secured by a lien on the vehicle in the purchase or refinance of a car.” (Title 10 California Code of Regulations § 1430)

Title loans are a relatively small but growing subset of small dollar consumer loans. Title loans accounted for approximately 13% of all CFL small dollar consumer loans in 2016 with a total loan volume of \$377 million. The title loan market has grown significantly over the past five years, with annual loan volume 72% higher in 2016 than 2012.

Title loans are expensive for borrowers and costly to administer for lenders based on current industry standards and business practices. Due to a combination of borrower credit quality and the cost structure of the industry, nearly 60% of title loans had an interest rate of more than 100% in 2016 and an additional 35% of loans had an interest rate of 70%-100% (see Chart 1).

Chart 1



3) POLICY PROBLEM

The author is concerned that weak underwriting standards in the title loan industry are leading to negative outcomes for consumers, including high vehicle repossession rates and high average interest rates on loans. In 2016 over 20,000 consumers in California lost their vehicle to repossession after defaulting on a title loan, compared to 108,080 total title loans originated. These data indicate that a proportionately high number of consumers are offered loans that they cannot repay, even in spite of the looming threat that they could lose their car

if they fail to make a payment. The author's concerns were magnified after her staff met with the CEO of a leading auto title lender who described his firm's underwriting practices as focused on the value of the car, rather than the consumer's income and debt obligations. Given the growing prevalence of title loans, the author seeks to establish standards that will incentivize underwriting upfront and reduce the rate of financial hardship that occurs when consumers get into a loan that they cannot afford to repay.

The Department of Business Oversight issued a consumer advisory in December 2014 in response to the growing prevalence of title loans in California. As the state regulator charged with enforcing consumer financial protections, the DBO was particularly concerned that consumers were putting one of their most important assets at risk in exchange for a high cost loan. The advisory warned consumers that although title loans are quick and easy to obtain, consumers pay higher prices for the convenience.

Media reports have also highlighted concerns with the auto title industry. The LA Times published an article on June 7, 2015 titled "More auto title lenders are snagging unwary borrowers in cycle of debt." The article described Jennifer Jordan's experience with a title lender. Jordan sought a \$400 loan to meet her monthly expenses, but the title lender said it would not make a loan that small. The lender offered her a \$2,600 loan at 153% interest, and Jordan pledged her 2005 Buick as collateral. The lender did not consider Jordan's monthly income of \$900 from disability benefits when it offered her the loan with a \$345 monthly payment. Six months after taking out the loan, Jordan could not keep up with the payments and her vehicle was repossessed.

4) PROPOSED SOLUTION

This bill proposes a 36% APR cap on title loans, extending similar protections to consumers as the federal Military Lending Act and California's Pilot Program for Increased Access to Responsible Small Dollar Loans (Financial Code Section 22365 et seq.). If this bill becomes law, California would join 25 states and the District of Columbia that cap title loan APRs at no higher than 36% or explicitly prohibit lending against a car title.

The 36% cap would provide a strong incentive for lenders to conduct ability-to-repay underwriting before offering a title loan to a consumer. The repossession process is costly for lenders to administer, and the 36% cap will prevent lenders from sustaining a profitable business if their borrowers continue to default at such a high rate.

Auto title lending that is predicated on ability-to-repay underwriting will continue to be available if this bill becomes law. One of the largest providers of small dollar consumer loans in California performs underwriting to establish a prospective borrower's ability to repay. If the consumer qualifies for an unsecured loan, the lender may also offer the option for a secured loan at a lower price, and the consumer gets to decide which loan fits their needs. The author's office has confirmed with the lender that this bill will not prevent the lender from continuing to offer this option to consumers.

5) SUPPORT

Writing in support, the Western Center on Law & Poverty states that AB 2953 "would eliminate the practice of charging triple-digit interest rates on consumer loans that require a vehicle pink slip to secure the loan." The letter states the importance of vehicles to the

financial health of families and cites studies that have found strong, positive impacts of vehicle ownership on employment outcomes for lower-income households.

Consumer Attorneys of California states:

Title loans are an especially risky form of loan for consumers. Those who seek title loans are often in extreme financial turmoil and cannot receive loans from traditional credit agencies. Given their financial instability, title loan consumers are likely to default on the high-interest payments required by title lenders, resulting in the loss of their most valuable asset and means of transportation.

AB 2953 is a good first step to ensure that title loan lenders do not utilize predatorily high interest rates to take advantage of consumers who are already facing economic hardship.

6) OPPOSITION

The California Financial Service Providers Association (CFSP) represents businesses that provide alternative financial services, such as payday loans, check cashing, installment loans, and title loans. CFSP asserts that the proposed policy would harm consumers with already limited access to financial products and believes that consumers will turn to unregulated lenders for their credit needs. CFSP states that “the interest rate proposed by this bill is simply unworkable and would shut off access to credit for the consumers that rely on this type of loan.”

7) RELATED LEGISLATION

AB 2500 (Kalra), 2017-18 Legislative Session: Prohibits CFL licensees from receiving charges on a consumer loan at a rate exceeding 36% APR of the unpaid principal balance of a loan from \$2,500 to \$5,000 and 24% APR of the unpaid principal balance of a loan from \$5,000 to \$10,000. Requires the cost of optional credit insurance to fit within the proposed rate caps. Adds consumer protections related to refinancing and minimum loan terms.

REGISTERED SUPPORT / OPPOSITION:

Support

Consumer Attorneys of California
Greenlining Institute
Western Center on Law & Poverty

Opposition

California Financial Service Providers
Cashback Loans
Community Loans of America
Loan Mart
TMX Finance

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