Date of Hearing: January 9, 2012

ASSEMBLY COMMITTEE ON BANKING AND FINANCE
Mike Eng, Chair
AB 336 (Dickinson) – As Amended: January 4, 2012

SUBJECT: Title Loans

SUMMARY: Establishes standards, prohibitions and requirements on lenders that provide loans collateralized by a motor vehicle (Car title loans). Specifically, this bill:

1) Defines "title loan" as a nonpurchase money loan where the lender obtains a security interest in a motor vehicle, which security interest is perfected by a first lien.

2) Requires a licensee that makes a car title loan to do the following:

   a) Provide the consumer with a disclosure that informs the consumer of the interest rate and any fees or other charges associated with the consumer loan, the consequences for defaulting on the consumer loan, and a complete amortization schedule indicating the total cost to the consumer over the life of the loan and samples of other term options.

   b) Provide to the borrower a "High Interest Rate" disclosure in Bold Arial in at least 16 point font, all capital letters. The disclosure must be in a separate box and must be signed by the borrower and any additional cosigner, if any. The High Interest Rate Disclosure shall contain the following words: THIS IS A HIGH-COST LOAN. YOU MAY BE ABLE TO OBTAIN A LOAN FROM ANOTHER SOURCE AT A LOWER RATE OF FINANCE CHARGE. THINK CAREFULLY BEFORE YOU DECIDE TO ACCEPT THIS LOAN.

   c) Underwrite each loan to determine a borrower's ability and willingness to repay the loan pursuant to the loan terms, and shall not make a loan if it determines, through its underwriting, that the borrower's total monthly debt service payments, at the time of origination, including the loan for which the borrower is being considered, and across all outstanding forms of credit that can be independently verified by the licensee, exceed 50 percent of the borrower's gross monthly income.

   d) Seek information and documentation pertaining to all of a borrower's outstanding debt obligations during the loan application and underwriting process, including loans that are self-reported by the borrower but not available through independent verification.

   e) Verify the borrower's credit information using a credit report from at least one of the three major credit bureaus or through other available electronic debt verification services that provide reliable evidence of a borrower's outstanding debt obligations.

3) Prohibits the structuring of a car title loan as a sale-lease-back transaction and provides for civil penalties.

4) Provides that if a borrower defaults on a car title loan and if the licensee disposes of the vehicle used as collateral for the loan then the borrower shall not owe a deficiency, nor shall the licensee request a deficiency judgment to recover any outstanding balance.

5) Prohibits the use of any prepayment penalty on the car title loan.

6) Provides that if the borrower fails to perform their obligations under the loan, the licensee shall not make any negative report to any of the national credit reporting agencies.

7) Requires that any advertisements used for car title loans must include the annual percentage rate (APR) of the loan.

8) Specifies that the lender must provide at least 30 days' notice, via personal service or certified mail, of intent to dispose of a repossessed or surrendered vehicle. Additionally, notice shall inform borrower of their right to redeem the vehicle by paying in full the indebtedness.

9) Provides that licensee shall extend redemption period for additional 10 days if the loan is subject to a conditional right of reinstatement.

10) States that unless automatically provided to the borrower, the licensee shall provide a written accounting regarding the disposition to any person liable on the loan within 45 days after his or her written request. The accounting shall provide the following:

    a) The gross proceeds of the disposition.

    b) The reasonable and necessary costs and fees authorized by this division incurred in repossessing the motor vehicle.

    c) Satisfaction of other liens that may be on the vehicle.

11) Provides that in all sales of a disposed or repossessed vehicle that results in a surplus the licensee shall furnish an accounting and return the surplus to the borrower.

12) Allows a person to bring an action for the recovery of damages, equitable relief, exemplary damages, and attorney's fees and costs for any violation of this section.

13) Allows for a civil a penalty for a violation of up to $10,000 for each violation which shall be assessed and recovered in a civil action brought in the name of the people of the State of California by the Attorney General, a district attorney, or a city attorney in a court of competent jurisdiction.

EXISTING LAW

1) Provides for the California Finance Lenders Law (CFLL), administered by the Department of Corporations (DOC), 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 CFLL:

    a) CFLL 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). Administrative fees are capped at the lesser of 5% of the principal amount of the loan or $50. An administrative fee of $75 may be charged for loans of $2,500 or more (Section 22305);

b) In addition to the requirements in "a" above, CFLL 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);

c) In addition to the requirements in "a" and "b" above, CFLL 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); and,

d) Generally speaking, the terms of loans of $10,000 or above are not restricted under the CFLL.

2) Authorizes the licensure of finance brokers under the CFLL, and defines a finance broker as any person who is engaged in the business of negotiating or performing any act as a broker in connection with loans made by a finance lender (Section 22004).

3) Imposes a 36% APR on consumer credit extended to members of the military and their dependents. (10 USC Sec. 987.)

FISCAL EFFECT: None

COMMENTS:

A car title loan occurs when a consumer borrows money against the title of their car for a specified period of time. During the loan period, the consumer continues to use their vehicle as necessary. If the consumer defaults on the loan then current law authorizes the lender to repossess the car for the costs of the loan. Car title lending in California is conducted under the CFLL, under which various forms of consumer lending are authorized. The CFLL does not explicitly authorize car title lending, but CFL licensees may offer these types of loans. Car title loans are subject to the provisions of the CFL, which for loans above $2,500 no interest rate caps exist. A rate cap does not exist for any personal loan (Auto, Auto-title, personal) made under the CFLL.
Car title lending has come under recent scrutiny due to media coverage, specifically, an LA Times article, "Title Loans' Interest Rates are Literally Out of Control," February 11, 2011, that highlighted the high interest rates on these loans and the consequences if a consumer does not pay off such a loan. The article provided the following details:

- One customer put up his truck as collateral for a $2,500 loan with payments of $200 per month. The customer expected to pay off $5000-6000 by the time the loan was finished. This particular customer was charged an APR of 108% as a return customer vs. 120% for new customers.

- According to one car title lender interviewed, three quarters of the loans were paid off typically within 8 months.

- The way in which a typical loan would work, is the customer brings in his or her vehicle to the lender for inspection and test drive. The lender then determines what the vehicle might fetch at auction, which could be half of the Kelley Blue Book Value. For example, with a $6,000 Blue Book value the lender might loan $2,600 with interest rates as much at 180% APR.

Industry representatives argue that the borrowers who use their service have very low credit scores and are not likely to have access to other means of credit, if at all. Additionally, they point out that while the loan may be securitized, the repossession and disposition of an automobile is a costly endeavor and such costs must be built into the costs of the loan.
In examining at CFL licensees who make secured car loans (This includes car title loans and car purchase loans) finds that in 2009 approximately 18,921 auto related loans were made in California with APRs over 40%, for a total volume of $64,204,118. In 2009, for loans with APRs over 100%, 4,243 loans were made, totaling $13, 948,175. Again, it is important to note that these numbers are approximations because an auto-purchase lender could be in these categories. Additionally, anecdotal information suggests that most car title loans are made with APRs between 90-120%.

Sale-leaseback:

A sale-leaseback is when a lender buys property from a consumer and then leases it back to the consumer for a "rental" payment due at specified intervals. In effect, these transactions are loans designed to avoid enforcement of stricter lending laws. AB 336 would ban a sale-leaseback transaction by providing that in sales transaction involving a motor vehicle, if the seller is leased the vehicle then it shall be presumed it is a sale-leaseback transaction that is attempting to avoid the requirements and restrictions on car title loans.

In 2005, Governor Schwarzenegger vetoed SB 360 (Florez) which would have banned sale-leaseback transactions. As part of the veto message, DOC was tasked with developing a proposal to address this issue. On March 1, 2006, DOC issued release No. 56-FS regarding these transactions and how the DOC would view these transactions and released the following information:

> In an effort to address these concerns, the Department of Corporations has prepared the following list of factors, according to California law, that it will use to determine whether a sale-leaseback transaction may be a loan:
>
> - The borrower seeks money and not the use of goods or property.
> - The borrower receives money, followed by a “sale” of the borrower’s property to the lender, with a provision for repayment in the form of rent or payments to the lender.
> - The borrower is in possession of the goods or property before obtaining money from the lender.
> - The borrower gives up title to goods or property as security in exchange for receiving money.

- There is no risk to the lender of losing capital, other than the insolvency of the borrower.

- The lender has the power to accelerate the principal payment of the "loan" upon default.

- The transaction includes agreements with provisions of title reversions and "repurchase" within specified periods.

> The presence of one or more of these factors may indicate, upon further review, the presence of a loan transaction. The mere fact that a sale-leaseback transaction is titled or referred to as a "lease" or a "sale-leaseback" in the forms and paperwork is not determinative. It is the intent of the parties and the economic substance of the transaction, rather than the form of the transaction, which determines whether the transaction is actually a loan. Thus, the Department will examine a so-called sale-leaseback transaction in accordance with the above-referenced factors, in addition to other circumstances including the purpose and terms of the agreement, to help determine whether such transaction may be a loan when enforcing the CFLL.

The existence of the aforementioned guidance issued by DOC does not necessarily negate the need to codify a ban on sale-lease back transactions that may attempt to circumvent the requirements on car title lenders. However, the author may want to consider incorporating provisions of the guidance in the ban on sale-leaseback transactions.

Arguments in support:

The Center for Responsible Lending writes in support:

> Under the California Finance Lenders Law, car title lenders operate with no interest rate limits for loans greater than $2,500. Car title lending is particularly usurious, with lenders in California charging annual interest rates that range from 72 percent to as high as 180 percent. Like payday lenders, car title lenders target vulnerable borrowers who need quick cash. Also, like payday lenders, they have no incentive to rigorously evaluate a borrower's ability to repay the loan because they are assured repayment either through borrower payments or the repossession and sale of the borrower's car. These loans are especially risky for borrowers because they put the borrower's car at risk. The car is likely to be the borrower's most valuable asset, and is often the borrower's only means of getting to work. A repossession can be devastating if the loss of this valuable asset also means the loss of transportation to work, and leads to unemployment.
>
> Car title lenders often argue that such high rates are justified by the credit risk of the borrower. In reality, though, the car title lenders bear little risk because the loan is more than 100 percent secured by the value of the automobile. This is because loan amounts are almost always only a fraction of the full value of the car. There are, however, a wide array of more responsible options available for qualified, creditworthy borrowers – credit cards, banks and credit unions, other consumer finance lenders, all of whom offer credit to a wide swath of borrowers who can afford to repay a loan, but rarely charge APRs in excess of 36 percent. The excessive interest rates charged for fully secured car title loans

are a core problem with car title loans that go unaddressed in the amended version of AB 336.

Consumers for Auto Reliability and Safety write in support:

> For most Californians, a motor vehicle is a necessity of life. Citizens of our state rely on their motor vehicles to get to work, transport their children to school, gain access to vital medical care, and get groceries. Exorbitant interest rates increase the risk of defaults, leading to vehicle repossessions. When vehicles are repossessed, very often an immediate consequence is job loss. Thus, the practices are costing our state jobs and contributing to unemployment.
>
> Further exacerbating the harm, once consumers have a repossession on their credit report, it stays on their report for 7 years. During that time, they are subject to being turned down for employment and housing. Existing law in California allows employers to discriminate based on credit histories, and someone who has a repossession on their record is likely to be summarily eliminated from the pool of eligible employees.

Consumer Attorneys of California writes in support:

> Consumer Attorneys of California is pleased to support AB 336 (Dickinson), which is set to be heard before the Assembly Banking and Finance Committee on January 9, 2012. "Auto title lending" is the practice in which a lender makes a loan to a consumer with the loan secured by title to the borrower's automobile. Consumers often choose auto title loans because they provide quick and easy access to cash, and because credit ratings are not used to determine eligibility. Too often, however, needy consumers utilize these loans without understanding the intricacies of the repayment and the default process. The repercussions of default on these loans can be devastating (consumers can lose their car, cash, and their good credit histories) and legislation is needed to help protect innocent Californians.

<u>Arguments in opposition.</u>

California Financial Services Association writes in opposition:

> 22328.6 (D)(2) – Requires a creditor to "ensure" that the borrower read and understood the disclosure. A creditor has no way of knowing whether the borrower understands the contract, other than the borrower's affirmation that they do by virtue of signing the contract. Consequently, a borrower need only assert that they did not understand the contract in order to file suit under (h)(1) and (h)(2). We are unaware of any other statute that provides a consumer with a private right of action and $10,000 bounty for their own failure to understand a contract which they signed.
>
> 22328.6 (D)(3) – Requires a creditor to "independently verify" a borrowers total debt service and precludes a creditor from making a loan that exceeds 50 percent of a borrowers monthly income after debt service. Existing law already requires a lender to consider the ability of a borrower to repay a loan. However, by adding a requirement to "independently verify" debt service this bill would presumably mandate credit reports, talking to landlords, employers, other creditors, etc. This independent verification is

impractical at best, will significantly slow the lending process and will preclude anyone (immigrants) that does not have a Social Security number from obtaining a loan because a lender cannot obtain a credit report. The delays in waiting for independent verification from the afore-mentioned entities would invariably result in heartache for consumers, many of whom need the proceeds as quickly as possible. Additionally, because the notion of independent verification is so vague (i.e. does this mean a lender would have to contract with an independent third party?), lenders would invariably be subjected to frivolous litigation pursuant to (h).

Precluding lenders from making loans that exceed 50 percent of a borrowers monthly income, minus existing debt service, would effectively ban title loans for borrowers in high cost urban areas such as Los Angeles, San Francisco, San Jose, etc. where housing costs make up a higher percentage of one's debt service. The provision also runs counter to other provisions in the bill concerning a borrower's ability to repay because it assumes that anyone with high housing costs is a bad credit risk.

22328.6 (A) and (C) – Requires the creditor to provide a complete amortization schedule including the "total cost" as well as all "fees" to the consumer. As evidenced by last year's AB 238 (Huber) concerning conditional sale contracts, which you voted for, certain fees, especially government assessed and third party fees, are often difficult to calculate. Prior to the passage of AB 238 there was a thriving business for attorneys to file suit over minor calculation errors. Given the penalty provisions in this measure and the fact that there is no safe harbor, these same attorneys will find a new area to thrive and lenders would invariably be subjected to frivolous litigation pursuant to (h)..

22328.6 (c) – Precludes creditors from obtaining deficiency judgments from borrowers. Including a no recourse provision would force lenders to raise rates for all borrowers, including those who actually pay on time, in order to make up for the deficiencies that will be inevitably left over by the non-paying customers against whom the lender would then have no recourse. The inclusion of this provision would incentivize customers to mislead lenders or abuse vehicles, would lead to an increase in repossessions earlier in the delinquency cycle due to exposure and would incentivize lenders not to repossess low value vehicles from impound, repair shops, etc., in order to mitigate losses, because now lenders would be better served to sue for the entire balance.

22328.6 (d) – Precludes creditors from making negative credit reports to national crediting agencies. Aside from violating the Fair Credit Reporting Act and arguably being unconstitutional, this provision conflicts with other portions of the bill which require creditors to obtain complete credit data on borrowers. In effect, this provision devalues the very credit reports which this measure wants to mandate and makes it more likely that unqualified borrowers are able to obtain loans which they may be unable to repay.

Issues for consideration.

1) Debt to income restriction: This bill would prohibit the making of a loan if the borrower's debt to income ratio, including the new loan, would exceed 50% of the borrower's gross monthly income. It is possible that a borrower in the need of a car title loan most likely already exceeds the 50% DTI standard. Would this standard deny credit to those who may

need it the most? Additionally, with the underwriting mandates and the ability to repay standard in the bill, is a hard DTI cap necessary? Do we really have evidence of the current DTI ratio of borrowers? Perhaps DOC could require licensees, via regulation to collect DTI ratio information, for future policy decisions.

2) Prohibition on negative reporting to national credit reporting agencies if borrower defaults. While the bill requires that the lender document outstanding debts of the consumer in the underwriting process, the prohibition on reporting a default to the credit bureaus is counter to the need to evaluate all of borrower's debts. What if a borrower had more than one vehicle and they defaulted on one title loan to only to get a second title loan? Under this scenario the lender would have no way of knowing (unless it was the same lender) that the borrower was a credit risk as they had defaulted on the exact same type of loan. Finally, opposition has provided that this provision would violate the federal Fair Credit Reporting Act (15 U.S.C. § 1681 et seq). Committee staff is not convinced of this claim and that the previous reasons mentioned regarding the problems of this provision are sufficient to justify its exclusion from the bill.

3) The bill requires that the lender must ensure the borrower "has read and understood..." the loan disclosure information. It does not specify how one would ensure that the borrower has read and understood the disclosures. Considering the penalties for a violation in this bill it would be appropriate to specify what constitutes compliance.

4) Other technical issues. The bill has other technical and drafting issues that need to be addressed.

Based on the aforementioned issues, committee staff recommends that amendments should be adopted in committee to address these issues.

REGISTERED SUPPORT / OPPOSITION:

Support

Consumer Attorneys of California
Consumers for Auto Reliability and Safety (CARS)
The Center for Responsible Lending (CRL)

Opposition

California Financial Services Association (CFSA)
Community Loans of America Inc.
Equal Access Auto Lenders of California (EAALC)

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