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Michael H. Anderson

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MICHAEL H. ANDERSON*

INTRODUCTION

The purpose of this essay is to provide an introduction and context to the seemingly ubiquitous subprime financing industry. Subprime financing, while encompassing many mechanisms, refers to non-traditional lending which does not rely on the credit history of the borrower and is typically done by non-depository institutions. The fact that such lending is readily available, and that consumers with no credit or bad credit qualify, makes subprime loans appealing to low income or financially constrained consumers.[1] Because of the nature of the customer base and the high cost of the supplied credit, critics of these businesses have long been concerned that these services are exploitive and in need of strong regulation and governmental oversight.[2]

In looking at subprime financing, we note an interesting historical symmetry. The 1970s and early 80s were a very challenging time for the U.S. economy. The creation of the Organization of Petroleum Producing States (OPEC) and the subsequent quadrupling of oil prices helped create three recessions between 1973 and 1981.[3] Participants in the economy discovered that stagflation, defined as high unemployment and high inflation, was possible.[4] This period saw the popularization of the "misery in-

* Professor of Finance, Charlton College of Business, University of Massachusetts Dartmouth. The author's address is 285 Old Westport Rd., North Dartmouth, MA 02747. The author may be reached via email at manderson@umassd.edu or by phone at (508) 999-9185.

1. *See* Emory W. Rushton, *Subprime Lending Description: Risks and Rewards*, OCC.TREAS.GOV (April 5, 1999), http://www.occ.treas.gov/news-issuances/bulletins/1999/bulletin-1999-15.html (providing a definition and overview of subprime lending from the standpoint of bank loans).

2. For example, the Consumer Federation of America has been a consumer advocate since 1968. *See Overview*, CONSUMER FED'N OF AM., http://www.consumerfed.org/about-cfa/overview (last visited Oct. 4, 2013). The United States Public Interest Research Group has opposed Rent-to-Own since 1994 when it released a report entitled "Rent to Own = Ripping Them Off." *See* Kim I. Mills, *Rent-To-Own Stores Accused of Ripping People Off*, DESERET NEWS, May 14, 1994, *available at* http://www.deseretnews.com/article/340567/RENT-TO-OWN-STORES-ACCUSED-OF-RIPPING-PEOPLE-OFF.html?pg=all.

3. *See US Business Cycle Expansions and Contractions*, NAT'L BUREAU OF ECON. RESEARCH, http://www.nber.org/cycles/cyclesmain.html (last visited Oct. 4, 2013).

4. *See* N. GREGORY MANKIW, PRINCIPLES OF MACROECONOMICS 453 (6th ed. 2011).

dex," the sum of unemployment and inflation.[5] High inflation and general economic uncertainty lead to a period of high interest rates unprecedented in modern times.[6] Because lending rates are set at a spread above investment rates, this effectively curtailed most lending, especially to consumers, as few could afford to pay such rates.[7] Additionally, in some states, usury ceilings shut down consumer loan markets.[8] All this created the need for so-called "creative financing." For instance, in the housing market, new mortgage origination greatly slowed as consumers expended much effort maintaining rather than rolling over older, lower fixed rate mortgages.[9] It also opened the door to the growth of subprime lending as consumers sought ways to finance needed acquisitions.[10]

Today, the market for subprime financing has also been growing significantly. Unlike thirty years ago, however, today our interest rates are too low. As of this writing, we are five years into a Federal Reserve policy, commonly referred to as ZIRP, of keeping interest rates at near zero.[11] The reason the Fed is following ZIRP is to help the economy recover from the so-called Great Recession[12] that officially ran from December 2007 to June

5. The "misery index" was first coined in the 1960s by Arthur Okun. *See United States Misery Index*, NPA SERVS. INC., www.miseryindex.us (last visited Oct. 4, 2013).

6. For instance, the ten year Treasury Bond, a key benchmark rate, was ten percent or higher from October 1979 to November 1985, topping out at 15.32% on September 1, 1981. *10 Year Treasury Rate by Month*, MULTIPL.COM, http://www.multpl.com/interest-rate/table?f=m (last visited Oct. 4, 2013).

7. According to the Federal Reserve, the Prime Rate (the rate offering to the most credit worthy customer and so the lowest borrowing rate) broke ten percent in November, 1978 and stayed above that until May, 1985, peaking at 20.38 percent in July, 1981. *Selected Interest Rates (Daily) tbl. Bank Prime Loan: Monthly*, FEDERALRESERVE.GOV, *available at* www.federalreserve.gov/releases/h15/data.htm (last visited Oct. 4, 2013).

8. Arkansas once had a fixed ten percent usury ceiling on consumer lending, with the result that consumer lending could not be profitable and so largely ceased to exist; this regulation was not changed until 1982. ARK. CONST. of 1874, art. XIX, § 3 (*amended* 1982, *repealed* 2010). However, note that Louisiana still has a twelve percent usury ceiling on conventional loans. LA. REV. STAT. ANN. § 9:3500 (2005).

9. *See* Jerry Green & John B. Shoven, *The Effects of Interest Rates on Mortgage Prepayments*, 18 J. OF MONEY, CREDIT AND BANKING 1, 41-59 (1986) (analyzing interest rates and mortgages), *see also* IRA S. LOWRY, CREATIVE FINANCING IN CALIFORNIA: THE MORNING AFTER 1 (The Rand Corp. ed., 1983), *available at* www.rand.org/pubs/reports/2007/R3081.pdf (same).

10. *See, e.g.*, Andrea Ryan, Gunnar Trumbull & Peter Tufano, *A Brief Postwar History of US Consumer Finance*, 85 BUS. HIST. R. 461, 465 tbl. 1 (2011).

11. The Fed Funds rate, a key benchmark rate targeted by the Federal Reserve, has been kept at 0.25 percent or less since December 2008. *Historical Changes of the Target Federal Funds and Discount Rates*, N.Y. FED. RES., http://www.newyorkfed.org/markets/statistics/dlyrates/fedrate.html (last visited Oct. 4, 2013).

12. Fed Chairman Ben Bernanke has stated he has a continued commitment to easy-money policies and "that the Fed is better prepared to find and address financial instability than it was before the 2008 crisis." Victoria McGrane, *Fed Chief Stands Pat on Easy Money*, WALL ST. J., March 1, 2013, *available at* http://online.wsj.com/article/SB10001424127887323293704578334803548396628.html.

2009.[13] Further, the Fed has expressed a commitment to keeping rates low for the foreseeable future.[14] For individuals and institutions that have traditionally relied on fixed-rate investments, e.g., retirees, and pension and endowment funds, ZIRP is problematic, and this problem is exacerbated by the demographic trend of a rapidly aging U.S. At the same time, lower income consumers are also impacted. Improving one's economic situation by opening a savings account may not be tenable when the account does not pay any significant interest, and various fees may actually reduce the account balance over time.[15] Since the recession started, we have seen a significant drop in median household income, and an increase in Social Security Disability rolls and enrollment in the Supplemental Nutrition Assistance Program (SNAP, sometimes referred to as food stamps).[16] These factors combined, present a growth opportunity to the subprime industry.

This essay will discuss four common subprime mechanisms: rent-to-own, payday lending, pawn shops, and title pawn lending, respectively. Some conclusions on these industries are then stated in the final section.

I. Rent-to-Own

Rent-to-own (RTO) has been described in fuller detail in "An economic investigation of rent-to-own agreements" in an accompanying article in the symposium. RTO is a mechanism allowing consumers immediate access to merchandise—most commonly appliances, electronics, or furniture—with neither a credit check nor down payment. Instead, consumers agree to a series of payments. One interesting aspect of RTO is that consumers can choose their payment periodicity: monthly, semi-monthly, bi-weekly, or weekly.[17] Thus, consumers can choose to have a payment frequency in sync with their paydays, or in line with their planned contract

13. *See US Business Cycle Expansions and Contractions*, *supra* note 3.

14. For instance, the Fed has said it will keep short-term interest rates low until the unemployment rate slips below 6.5%, which is projected to be reached in mid-2015. Carolyn Cui, *Fed Seeks More Control Over Rates*, WALL ST. J., August 22, 2013, at C4.

15. The rise in fees is another consequence of low rates as banks try to replace lost interest revenue with higher consumer fees.

16. Median income in inflation-adjusted 2011 dollars has dropped over eight percent since 2007.U.S. CENSUS BUREAU, MEDIAN HOUSEHOLD INCOME BY STATE TBL. H-8, *available at* http://www.census.gov/hhes/www/income/data/historical/household/ (last visited Oct. 4, 2013). SNAP usage is up seventy percent since 2008. Damian Paletta & Caroline Porter, *Use of Food Stamps Swells even as Economy Improves*, WALL ST. J., Mar. 27, 2013, *available at* http://online.wsj.com/article/SB10001424127887323699704578328601204933288.html.

17. For example, Aaron's offers a monthly schedule but allows you to choose how many months, 6, 12, 18 or 24: *See Aaron's Leaseplus*, AARON'S, INC., http://www.aarons.com/t-lease-plus.aspx (last visited Oct. 4, 2013). Rent-A-Center allows weekly, semi-monthly or monthly schedules: *How RAC Works*, RENT A CENTER, INC., http://www6.rentacenter.com/how-rac-works/how-rent-a-center-works. (last visited Oct. 4, 2013).

usage. The agreement is for a fixed time period, usually twelve to twenty-four months. At the same time, the customer maintains the ability to terminate the arrangement at any point either by returning the item or by making a final lump sum payment. If all payments are made or the early purchase option is utilized, the customer takes ownership of the merchandise. However, no adverse credit action occurs if the consumer decides to terminate payments early. Adding to the value of the transaction, merchandise delivery, set-up, and service (as well as pick-up, if required) are all included.[18]

Since its beginning in the 1960s, the RTO industry has grown to over 9,800 stores in the U.S., annually serving over six million customers, and generating over $8.5 billion in revenue.[19] The industry consists of two publicly traded companies—Rent-A-Center (RAC) and Aaron's—and a number of privately owned businesses. RAC (and its subsidiary Color-Tyme) is largest with thirty-two percent of the RTO stores in the U.S.[20] Aarons, along with its franchises, is second with twenty one percent.[21] RAC and Aaron's taken together generate sixty percent of the industry's revenue.[22] RAC encourages weekly schedules, while Aaron's prefers monthly, and the privately owned companies generally offer a blend of payment frequencies.[23]

RTO is not regulated at the federal level; however, forty-seven states have passed laws regulating RTO.[24] State regulations can generally be organized into rules that require various disclosures, and rules that place

18. *See The Rent to Own Industry: An Overview*, ASS'N OF PROGRESSIVE RENTAL ORGS., http://www.rtohq.org/about-rent-to-own/ (last visited Oct. 4, 2013) (discussing how rent to own transactions operate); *see also* Michael H. Anderson, *Rent-to-Own Lending*, *in* CONSUMER SURVIVAL: AN ENCYCLOPEDIA OF CONSUMER RIGHTS, SAFETY, AND PROTECTION (Wendy Reiboldt & Melanie Horn Mallers eds., forthcoming 2013) [hereinafter CONSUMER SURVIVAL] (same).

19. ASS'N OF PROGRESSIVE RENTAL ORGS., supra note 18.

20. *Investor Relations*, RENT A CENTER, INC., http://investor.rentacenter.com/phoenix.zhtml?c=90764&p=irol-irhome (last visited Oct. 4, 2013).

21. AARON'S, INC., 2012 ANNUAL REPORT 5 (2013), *available at* http://phx.corporate-ir.net/External.File?item=UGFyZW50SUQ9MTc5MjEwfENoaWxkSUQ9LTF8VHlwZT0z&t=1.

22. RAC's 2012 revenue was $3.082 billion in 2012. RENT A CENTER, INC., 2013 PROXY STATEMENT: 2012 ANNUAL REPORT Form 10-K 13, *available at* http://phx.corporate-ir.net/External.File?item=UGFyZW50SUQ9MTc3NDk0fENoaWxkSUQ9LTF8VHlwZT0z&t=1. Aaron's 2012 revenue was $2.222 billion. AARON'S, INC., *supra* note 21, at 5.

23. For instance, of the over 180,000 Rent-A-Center transactions examined, 8.5 percent were monthly, 19.6 percent were bi-weekly and 71.9 percent were weekly. Michael H. Anderson & Raymond Jackson, *Managing High Risk in a Retail Operation: The Rent to Own Business*, 29 THE SOUTHERN BUSINESS & ECONOMIC JOURNAL 87, 89, 97 tbl. 4 (2006). Of 6,000 transactions examined from an independent RTO chain in the southeast, 18.5 percent were monthly, 25.8 percent were bi-weekly and 55.7 percent were weekly Michael H. Anderson & Sanjiv Jaggia, *An Empirical Look at Low Income Consumers and the Rent To Own Industry*, *in* LOW INCOMES: SOCIAL, HEALTH, AND EDUCATIONAL IMPACTS 245, 248 (Jacob K. Levin ed., 2009).

24. Ed Winn III, *Rent-To-Own at the Federal Level*, RTOHQ, www.rtohq.org/pdfs/LegUpdate_APRO_2011.pdf (last visited Oct. 4, 2013).

controls on permissible fees and prices. Eighteen states have mandated in-store price tag disclosures.[25] This typically requires the tag hanging on the merchandise on the store floor to disclose the cash price, the rental payment, number of payments and total dollar amount required for ownership.[26] All states that have passed legislation also mandate agreement disclosures—very much akin to requirements for consumer loan disclosures. Generally speaking, the contract must speak to whether the merchandise is new or used, the cost of ownership, the customer's rights, the terms of the options, if a manufacturer's warranty will apply after ownership, and other related information. Most states also have limits on fees, such as whether the store can charge an in-home collection fee when a store employee is be dispatched to a residence to collect payment.[27] The fee restrictions also address the length of any grace period for late payments that must be given and whether or not a reinstatement fee may be assessed if a transaction is resumed after having been temporarily suspended.[28] Finally, five states have placed caps on cash prices and total payment-to-term RTO prices, expressed as multiples of the store's wholesale cost.[29]

II. PAYDAY LENDING

Payday lending, or check advance loans, involves small dollar amount loans made for short periods of time. They typically are for $100 to $500 (up to $1,000 in some jurisdictions) lasting for two to four weeks.[30] The borrower instigates the loan by writing a post-dated check for the loan amount plus fees of $15 to $20 per $100 of principle.[31] At the due date, often the consumer's next payday, the customer may redeem his or her check with cash or simply allow it to be deposited. Due to the small loan size, this is necessarily a high volume business. For efficiency, the underwriting process is very streamlined: essentially verifying identity, income,

25. *Id*.

26. *Id*.

27. *See* Anderson & Jaggia, *supra* note 23, at 238 n.3 (of 136,275 analyzed payments, over 8,000 were picked up at the customers home).

28. *See* Winn III, *supra* note 24 add. (Specifications on Fees and Payments).

29. California, Hawaii, Maine, New York, and West Virginia have statutory caps. *See* Winn III, *supra* note 24 add. (discussing in-store price tag disclosures).

30. *See, e.g.*, *Payday Lending Statutes*, NAT'L CONF. OF ST. LEGISLATURES, www.ncsl.org/issues-research/banking/payday-lending-state-statutes.aspx (last visited Oct. 4, 2013) (providing a comprehensive, state-by-state list of payday lending statutes).

31. The precise fees vary by state. *See Cash Advance Rates / Fees*, CASH AM. INT'L, INC., http://www.cashamerica.com/LoanOptions/CashAdvances/RatesandFees.aspx (last visited Oct. 4, 2013) (providing a state-by-state listing of fees).

and the existence of a bank account.[32] In states that regulate the transaction, the firm may additionally have to verify loan eligibility by checking a central database.[33] While the presence of the post-dated check provides an easy collection mechanism, it cannot guarantee that there are sufficient funds; for example, loan loss rates between eight and fourteen percent of gross revenue have been recorded.[34]

The payday lending industry began in the early 1990s and has seen significant growth. There are currently 20,600 payday advance locations in the U.S. providing $38.5 billion in short-term credit to some 19 million households.[35] Six large companies control about twenty percent of the payday industry.[36] The largest firms in the industry are Advance America with over 2,500 locations;[37] and Cash America with over 1,000 locations.[38] The other major firms are ACE Cash Express Inc., Check 'n Go, Dollar Financial, and Check Into Cash; all four of which are publicly traded. The rest of the industry is composed of smaller local and regional firms. In addition, a few banks, including U.S. Bank and Wells Fargo & Co., offer a comparable product.[39]

The annual percentage rate (APR) on a payday loan can easily exceed 400 percent. Such APRs would normally be considered usurious; however, a commonly offered justification is that such loans are a cheaper alternative then the costs associated with overdrawing a bank checking account.[40] In

32. *See generally PayDay Loan Consumer Information*, CONSUMER FED'N OF AM., http://paydayloaninfo.org/ (last visited Oct. 4, 2013) (providing information on payday lending).

33. For instance, Veritec Solutions maintains real-time reporting databases to verify if a consumer is eligible for a loan. *Applying BI to Payday Lending Regulatory Solutions*, VERITEC SOLUTIONS, LLC, https://www.veritecs.com/PaydaySolution.aspx (last visited Oct. 4, 2013). *See also* Michael H. Anderson, *Payday Lending*, *in* CONSUMER SURVIVAL, *supra* note 18; Edward C. Lawrence & Gregory Elliehausen, *A Comparative Analysis of Payday Loan Customers*, 26 CONTEMP. ECON. POL'Y 299 (2008).

34. Lawrence & Elliehausen, *supra* note 33, at 302.

35. *About the Payday Advance Industry*, CMTY. FIN. SERVS. ASS'N OF AM., http://cfsaa.com/aboutthepaydayindustry.aspx (last visited Oct. 4, 2013).

36. *See* Michael A. Stegman, *Payday Lending*, J. OF ECON. PERSP. 169, 172 (2007).

37. ADVANCE AMERICA, CASH ADVANCE CENTERS, INC., FORM 10-K (ANNUAL REPORT), ADVANCE AM., CASH ADVANCE CENTERS, INC. 4 (2012), *available at* http://quote.morningstar.com/stock-filing/Annual-Report/2011/12/31/t.aspx?t=:AEA&ft=&d=c12cd1f791e34bf03980d4825adc1730. In 2012 Advance America was purchased by Mexican billionaire Ricardo Salinas; Erin Carlyle, *Mexican Billionaire buys Advance America*, *Largest Payday Lender In U.S.*, FORBES, April 23, 2012, *available at* www.forbes.com/sites/erincarlyle/2012/04/23/mexican-billionaire-buys-advance-america-largest-payday-lender-in-u-s/.

38. *Company History*, CASH AM. INT'L, INC., http://www.cashamerica.com/aboutus/CompanyHistory.aspx (last visited Oct 4, 2013).

39. This product is called a Direct Deposit Advance and is available for up to $500. *Direct Deposit Advance Frequently Asked Questions*, WELLS FARGO, https://www.wellsfargo.com/checking/direct-deposit-advance/faqs/ (last visited Oct. 4, 2013).

40. *See, e.g.*, Donald P. Morgan, Michael R. Strain & Ihab Seblani, *How Payday Credit Access Affects Overdrafts and Other Outcomes*, 44 J. OF MONEY, CREDIT, AND BANKING, 519, 519-520 (2012).

addition to high rates, consumer advocates are also concerned about a potential credit trap due to the financially constrained borrower's need to roll over these loans.[41]

While there are no federal regulations, a total of forty states and the District of Columbia have payday lending laws, which generally limit permissible fees, maximum loan amounts, and the number of such loans a consumer can have outstanding at any point.[42] Two states, Arizona and North Carolina, have allowed their payday loan regulations to sunset.[43] The remaining eight states either have no explicit regulations, or require payday lending to comply with consumer loan caps thereby effectively prohibiting payday lending.[44]

III. PAWN SHOPS

The pawn business is the making of secured loans to individuals using that individual's personal property as collateral. The pawn transaction is one of oldest financial transactions in existence. Pawning can be traced back three thousand years to ancient China, and was also present in early Greek and Roman civilizations.[45] The word pawn itself traces to the fifteenth century from a root word meaning "pledge" or "security."[46] The pawn business has become more visible in recent years. For instance, there are several reality-television shows set in pawnshops that are currently on the air.[47] There were an estimated 6,389 pawnshops in 2007,[48] and there are an estimated 10,000 shops as of January 2012.[49] The high price of pre-

41. *See, e.g.*, Lauren K. Saunders, Leah A. Plunkett & Carolyn Carter, *Stopping the Payday Loan Trap: Alternatives that Work*, *Ones that Don't*, NAT'L CONSUMER L. CENTER, http://www.nclc.org/images/pdf/high_cost_small_loans/payday_loans/report-stopping-payday-trap.pdf (last visited Oct. 4, 2013); *see also The CFPB Finds Payday and Deposit Advance Loans Can Trap Consumers in Debt*, CONSUMER FIN. PROT. BUREAU (April 24, 2013), www.consumerfinance.gov/pressreleases/the-cfpb-finds-payday-and-deposit-advance-loans-can-trap-consumers-in-debt.

42. *See* NAT'L CONF. OF ST. LEGISLATURES, *supra* note 30.

43. *See Operation Sunset FAQ*, ARIZ. ATT'Y GENERAL, *available at* www.azag.gov/sites/default/files/sites/all/docs/consumer/op-sunset-FAQ.pdf (last visited Oct. 4, 2013); *see also* N.C. Gen. Stat. § 53-281 (*expired* 2001). A bill to permit payday lending was proposed in the North Carolina legislature in 2013. *See* S.B.89, Sess. 2013 (N.C. 2013).

44. These eight states are Connecticut, Maryland, Massachusetts, New Jersey, New York, Pennsylvania, Vermont, and West Virginia. *See* Gerri Detweiler, *Trapped in Payday Loan Debt? How to Escape*, CREDIT.COM, INC., (April 4, 2013), www.credit.com/credit-law/payday-loan-laws.

45. *See History*, THE NAT'L PAWNBROKERS ASS'N OF THE UK, http://thenpa.com/pawnbroking_origins.asp (last visited Oct. 4, 2013); *see also Pawning Through the Ages*, HISTORY.COM, http://www.history.com/shows/pawn-stars/articles/pawning-through-the-ages (last visited Oct. 4, 2013).

46. THE COMPACT EDITION OF THE OXFORD ENGLISH DICTIONARY 2103 (1st ed. 1971).

47. *See, e.g.*, *Hardcore Pawn* (TruTV 2009), *Hardcore Pawn: Chicago* (TruTV 2013), *Pawn Stars* (History 2009).

48. NAT'L PAWNBROKERS ASS'N, *supra* note 45, at 7.

49. *Id.*

cious metals has led to an increased interest in pawning or selling one's jewelry and in the growth of the related "cash-for-gold" stores.[50] In addition to jewelry, electronics, collectibles, musical instruments and tools are commonly pawned. In some jurisdictions, firearms can be pawned.[51] Additionally, there has been some growth in Internet pawning, which can circumvent state and local regulations.[52] The vast majority of the industry is composed of independently owned stores or small regional chains; there are also three publicly traded companies. These represent less than thirteen percent of the industry.[53]

One reason for the popularity of a pawn loan is that it is independent of a customer's credit history and his or her ability to pay: as long as one has items to pawn, one has quick access to cash. Furthermore, unlike a conventional loan, defaults do not damage the credit history of the customer.[54] Additionally, customers also have the option to simply sell their items instead of pawning the merchandise. Handling the items bought outright and the collateral taken in is one thing that makes this business interesting. The possibility of default is part of the basic business model, with the pawnbroker being allowed to sell the collateralizing item to recoup their loan outlay plus interest and fees. It is incumbent on the pawnbroker to carefully value the item in question as well as to manage the quantities and mix of items in inventory to avoid losing on any particular item or class of item.

According to the National Pawnbrokers Association (NPA), the national average loan amount is under $150 and is for less than thirty days.[55] Over eighty-five percent of the pawn loans are repaid.[56] The transaction

50. *See* Karen Blumenthal, *The Other Gold Rush: Selling It*, WALL ST. J., October 23, 2010, *available at* http://online.wsj.com/article/SB10001424052702303339504575566070841984164.html.

51. Should a pawnshop choose to accept firearms, they are subject to the Gun Control Act § 922(t), the so-called "Brady Act." *See Brady Law*, BUREAU OF ALCOHOL, TOBACCO, FIREARMS, AND EXPLOSIVES, www.atf.gov/firearms/faq/brady-law.html#pawn-redemption (last visited Oct. 4, 2013). These pawnshops must then use the National Instant Criminal Background Check System. *See Id.*

52. For example, Pawngo offers a loan application that can be processed entirely online. *About Pawngo*, INTERNET PAWN, LLC, https://pawngo.com/about (last visited Oct. 4, 2013). As the National Pawnbrokers Association points out, such firms may avoid regulation if they are based off-shore or on tribal reservations. *See NPA Policy Statement: Internet Pawn Loans and Providers*, NAT'L PAWNBROKERS ASS'N, www.nationalpawnbrokers.org/internet-pawn (last visited Oct. 4, 2013).

53. These publically traded companies are Cash America International, Inc., EZCORP, Inc., and First Cash Financial Services, Inc. NAT'L PAWNBROKERS ASS'N, *supra* note 45, at 7.

54. With traditional loans, late or missed payments adversely impact one's credit score. *See What's In My FICO Score*, MYFICO.COM, www.myfico.com/crediteducation/whatsinyourscore.aspx (last visited Oct. 4, 2013).

55. *See* PAWN INDUSTRY OVERVIEW 2013, NAT'L PAWNBROKERS ASS'N 4, *available at* http://assets.nationalpawnbrokers.org/2010/10/NPA-Industry-Overview-2013-ln031913.pdf (last visited Oct. 4, 2013).

56. *Id.*

itself is conceptually simple. The pawnbroker gives cash for a pawned item. Within a set period, typically a month or two, the customer can reclaim the item by repaying the loan plus the specified interest. The length of time and interest rate are set by the pawnshop, though most jurisdictions have regulation limiting on the permissible interest rate.[57] Most states also have regulations requiring record keeping and reporting due to concerns that items being pawned are stolen property.[58]

Like other subprime financing, using a pawnshop is expensive. Shackman and Tenney considered the maximum interest on an $80, two month loan in all fifty states and Washington D.C., finding permissible rates as high as twenty-five percent a month: translating to an APR of 300 percent.[59] Further, they found that only ten jurisdictions had a requirement for the store to return any excess proceeds upon the sale of the collateral.[60]

IV. TITLE PAWN LOANS

A title pawn loan, or title loan, is a loan against the equity in one's vehicle. These loans range from small amounts borrowed for short periods of time, for example, $300 for thirty days, to much larger and longer term loans such as, $5000 for a year or more. For regulatory purposes, these loans may be classified as pawn loans; however, while a pawnbroker takes possession of a pawned item, here the borrower retains the use of the pawned vehicle, adding another element of risk to the transaction.[61]

There has been notable growth in title lending in recent years.[62] A significant portion of loan providers are independent operators, and a fair number are offering title loans as an offshoot of being engaged in a related

57. *Id.* at 5.

58. John P. Caskey, *Pawnbroking in America: The Economics of a Forgotten Credit Market*, 23 J. OF MONEY, CREDIT, AND BANKING, 85, 88-89 (1991) (pawnshops must file daily or weekly police reports listing all items pawned and identifying the individuals pawning the goods); *see also Safety Programs*, CASH AM. INT'L, INC., http://newsroom.cashamerica.com/safety (last visited Oct. 4, 2013) (discussing an internet-based crime-fighting tool called "leadsonline.com" that shares daily all transactions with police departments).

59. Joshua D. Shackman & Glen Tenney, *The Effect of Government Regulations on the Supply of Pawn Loans*, 30 J. OF FIN. SERVS. RES., 69, 80-82 (2006).

60. *Id.*

61. For instance, Georgia defines "pledged goods" to include "any motor vehicle certificate of title." GA. CODE. ANN. § 44-12-130(5) (2010).

62. For instance, in 2005, Tennessee reported 69,002 new agreements totaling $36,411,055. *See 2008 Report on the Title Pledge Industry*, TENN. DEP'T OF FIN. INSTS. 6 (2008), *available at* http://www.tn.gov/tdfi/compliance/tpl/TPLReport2008FinalFinal.pdf. In 2010, Tennessee reported 209,155 new agreements totaling $158,647,157, an average growth rate of 24.8 percent and 34.2 percent, respectively. *See 2012 Report on the Title Pledge Industry*, TENN. DEP'T OF FIN. INSTS. 5 (2012), *available at* http://www.tennessee.gov/tdfi/compliance/tpl/TDFI%202012%20Report%20Title%20Pledge%20Industry.pdf.

subprime financing business.[63] While there are no public companies in the business, there are several large private companies. For instance, TitleMax is a privately owned company, which started with one store in 1998 and currently has over 1,000 stores in twelve states.[64] Another is Auto Cash USA, which represents a network of lenders at over 500 locations.[65]

These loans require neither a credit check nor much documentation as they are, in essence, collateralized by the title to the borrower's vehicle.[66] Consequently, the proceeds can typically be obtained in one or two days, much faster than a conventional bank loan. Generally, all that is needed for the loan to proceed is for the lender to examine the vehicle to verify that it is worth enough more than the desired loan amount, net of expected reposition and auction costs, and to determine if the borrower has a clear title to the vehicle.[67]

For many financially constrained individuals, their car may be their most valuable possession. The value of that potential collateral to a title loan lender is created by the very large, active and liquid secondary market for vehicles that exists in the U.S.[68] The sizable secondary market gives lenders the ability to lend to a customer without proof of income or a conventional credit analysis. While this is a positive in terms of having access to credit, it is problematic in terms of ability to repay. The possibility of losing one's vehicle is very serious, especially for those in rural areas, and puts access to employment, health care and other essentials at risk.

Title pawn loans are unregulated at the federal level, although the Consumer Financial Protection Bureau is considering doing so.[69] State regulations vary widely: some states such as Connecticut, Maryland, and

63. For instance, Tennessee reports 179 lenders representing 762 locations, twenty-four percent being proprietorships or partnerships, and the top ten lenders having seventy-nine percent market share. *2012 Report on the Title Pledge Industry*, supra note 62, at 5.

64. *About Us*, TITLEMAX, INC., http://www.titlemax.biz/about-us/ (last visited Oct. 4, 2013).

65. *See Auto Cash USA*, AUTO CASH USA, LLC, http://www.autocashusa.com/ (last visited Oct. 4, 2013).

66. *See How Title Loans Work*, TITLEMAX, INC., http://www.titlemax.biz/how-it-works (last visited Oct. 4, 2013) (providing an overview of the title loan process).

67. *See* Michael H. Anderson, *Title Pawn Loans*, *in* CONSUMER SURVIVAL, *supra* note 18.

68. 9.7 million used vehicles were sold in the first quarter of 2013. *See* Arlena Sawyers, *U.S. Used-Vehicle Sales Drop 6% In First Quarter*, AUTONEWS, (May 14, 2013, 4:41 PM), www.autonews.com/article/20130514/RETAIL/130519945#; *see also* Mike Ramsey, *Amid New Car Boom*, *Used Cars are Gold*, WALL ST. J., February 21, 2013, *available at* http://online.wsj.com/article/SB10001424127887323511804578300650170654978.html (noting a strong demand for used cars).

69. In a June 23, 2011 interview, acting head Elizabeth Warren said title pawn loans were a focus of the Consumer Financial Protection Bureau. *See* Amy Biegelsen, *Credit Bureaus*, *Auto-Title Lenders*, *Debt Collectors Among Priorities of New Consumer Agency*, CENTER FOR PUB. INTEGRITY (June 23, 2011, 1:18 PM), http://www.publicintegrity.org/2011/06/23/4996/credit-bureaus-auto-title-lenders-debt-collectors-among-priorities-new-consumer.

Maine have banned title loans outright, while others have capped either the maximum interest that can be charged or the loan size.[70] For instance, in Illinois the maximum loan amount is $4,000,[71] while in Mississippi and Tennessee it is $2,500.[72] As a practical matter, the lender may be able to exploit a looser usury ceiling than would apply if the loan were classified as a consumer loan. For instance, in Georgia, the maximum permissible interest rate on a title pawn loan is twenty-five percent per month for the first three months of the loan after which it is capped at 12.5 percent per month—thus, loans up to three months can legally carry a 300 percent APR.[73] This is despite Georgia's consumer loan usury ceiling of sixteen percent on loans under $3,000 and five percent per month for larger loans.[74]

CONCLUSION

This essay surveyed some common types of subprime financing. It is striking just how small and short most of these loans are. It is hard for most of us to imagine how financially constrained an individual must be to need such a loan. Given the constraints placed on these consumers, it is often difficult for them to repay. Indeed, a very real concern is that many fall into a credit trap, wherein the only way these consumers can cover their expenses is to rollover their subprime loans, possibly repeatedly. A common anecdote about payday and title pawn loans is that they are two-week loans that take months or even years to pay off. The cost of subprime financing, expressed as an APR, can easily be 200 to a 1000 percent or more. Given the very short time frame on some of these loans, the APR may not be that useful a measure, but it is certainly clear that these loans can be very expensive.[75] Regulation and oversight of these businesses to prevent abuse is important. Product disclosures and consumer education are also essential. At the same time, from a policy standpoint, the best actions would be ones that provide or improve the safety nets available for low income individuals

70. *See Car-Title Loan Regulation*, CONSUMER FED'N OF AM., www.consumerfed.org/pdfs/Resources.CTL.StateLawTermChart12.2.12.pdf. (last visited Oct. 4, 2013) (providing a state-by-state overview of regulations).

71. ILL. ADMIN. CODE tit. 38, pt. 110.370(a) (eff. Apr. 1, 2009).

72. MISS. CODE ANN. § 75-67-415 (eff. Apr. 22, 1997), TENN. CODE ANN. § 45-15-115 (1996).

73. *See Title Pawns and Cash Advances*, GA. GOVERNOR'S OFF. OF CONSUMER PROTECTION, consumer.georgia.gov/consumer-topics/title-pawns-and-cash-advances (last visited Oct. 4, 2013).

74. *See* GA. CODE. ANN. § 7-4-2 (2010); *see also Georgia Usury Laws*, USURYLAW.COM, www.usurylaw.com/state/georgia.php (last visited Oct. 4, 2013).

75. For instance, a $10 fee to lend $100 for two weeks is an APR of 260 percent—but, instead of focusing on that APR, it would be more meaningful to disclose to consumers the loan's cost and, if it is rolled over, how exactly that loan can quickly get both expensive and difficult to payoff.

as well as encourage economic growth, so that consumers experience sub-prime financing as a transitional mechanism, if they have to experience it at all.