Consumer Protection Laws in Auto Lending

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We ask: How do **usury** and **wage garnishment laws** affect sub-prime auto loan **origination** and **outcomes**?

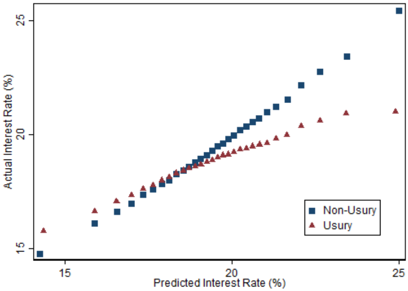
RESEARCH QUESTION

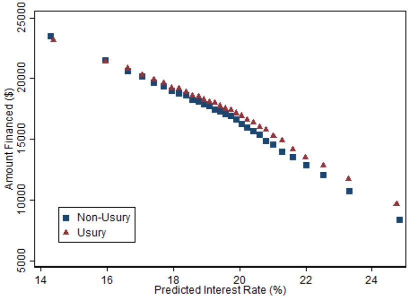
- Proprietary dataset **250,000 sub-prime auto loans**
  - Originated 1995–2017 $\longrightarrow$ follow loan outcomes **over time**
  - Covers 44 U.S. states $\longrightarrow$ examine variation in laws **across states**
- We generate a measure of **borrowers' creditworthiness**
  - We predict counterfactual APR in the absence of a usury limit

Dealers **circumvent** usury laws.

RESULT

- Borrowers **trade off** interest rate and principal to face **same** monthly payment in states with and without usury laws.
    - e.g. \$10,000 at 25% *or* \$11,078 at 20% for 60 months = \$294/month





- Consistent with patterns in aggregate data (Melzer & Schroeder 2017)

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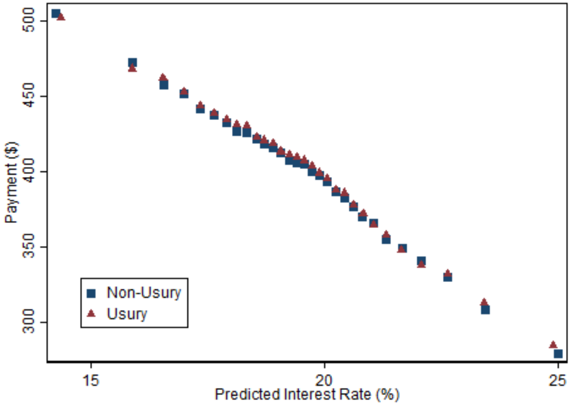
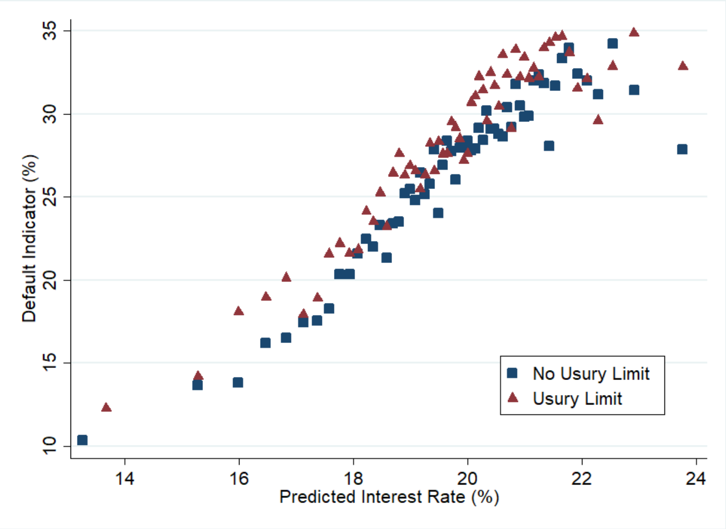


Loan outcomes **do not vary** with usury law.

RESULT

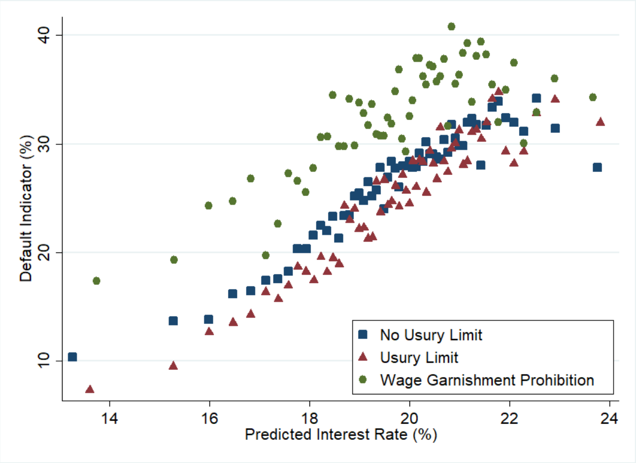
- Borrower default rates are **similar** despite higher opening balances.



However, loan outcomes **vary** with wage garnishment law.

RESULT

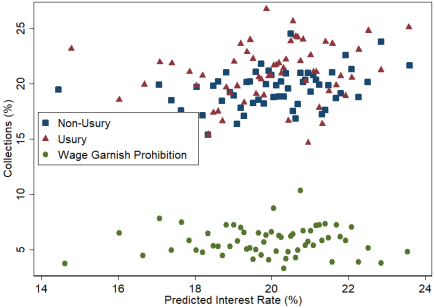
- 8 states prohibit/restrict wage garnishment (Hynes and Posner 2002).
- Default rates are **higher** in states that **prohibit** wage garnishment.

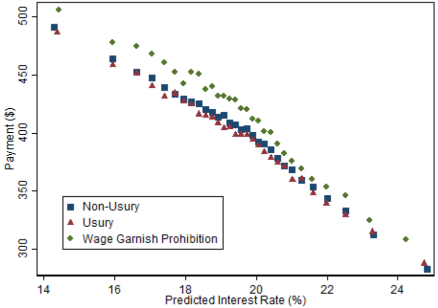


Why? **All borrowers** in states **without** wage garnishment face **higher** payments.

RESULT

- Defaulting borrowers are protected from collections
- Payments in states with collections restrictions are higher

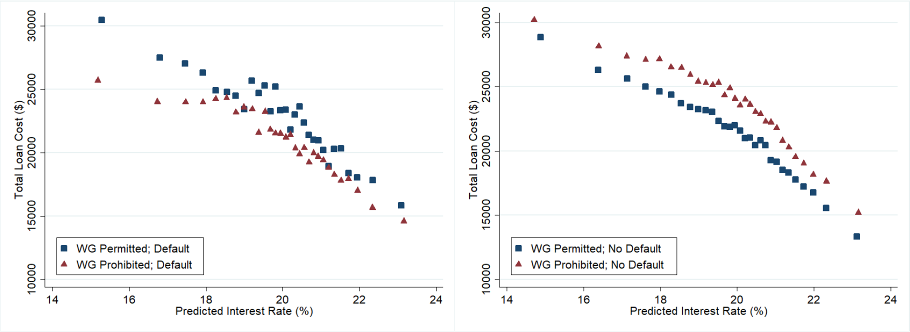




Total loan costs for non-defaulting borrowers are **higher** when wage garnishment is **prohibited**.

RESULT

- When borrowers are protected from post-default collections, total loan costs are **lower**.
- When payments are higher are borrowers who don't default, total loan costs for non-defaulting borrowers are **higher**.



Usury and wage garnishment laws protect some, **but may hurt**, other borrowers.

- Although dealers adjust loan terms, usury laws have **little** impact on loan outcomes: total borrowing costs and default rates are similar
- Wage garnishment laws affect **loan terms** and **outcomes**
  - With wage garnishment: lenders can collect from bad borrowers
  - Without wage garnishment: lenders must account *ex ante* for expected mix of good and bad borrowers.

- Why does this matter?
  - Defaults and repossession have long-lasting impact on individuals' formal credit scores, access to other forms of consumer credit, and employment prospects (Raphael et al. 2001)
  - We contribute to policy conversation by highlighting distributional consequences of two common consumer protection laws