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 → follow loan outcomes **over time**
  - Covers 44 U.S. states → 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)
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
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.

CONCLUSION

- 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.