# OCC ADVISORY LETTER

Comptroller of the Currency
Administrator of National Banks

Subject: Title Loan Programs

**TO:** Chief Executive Officers of All National Banks, Department and Division Heads, and All Examining Personnel

## PURPOSE

It has come to the attention of the Office of the Comptroller of the Currency (OCC) that title loan companies are approaching national banks urging them to enter into contractual arrangements to fund title loans. These arrangements also can involve the sale to the title loan company of the loans or servicing rights to the loans. The OCC has significant safety and soundness, compliance, and consumer protection concerns with title lending and with these arrangements.

The OCC recently issued two advisory letters reminding national bank boards and management of their need to exercise care and due diligence before engaging in certain credit practices. The first of these was OCC Advisory Letter 2000-7 (July 26, 2000), in which we alerted banks and our examiners regarding potentially abusive or predatory lending practices. Although that advisory letter focused primarily on the increased compliance risks and the potential for fair lending violations, it also noted the potential for increased credit risks. OCC Advisory Letter 2000-9 (August 29, 2000) subsequently focused on the risks associated with engaging in certain credit-related activities with third parties. That advisory letter stressed that bank management cannot rely solely on third-party assertions or representations when entering such relationships, and that bank management must include front-end management planning and risk analysis, appropriate due diligence in selecting vendors, and monitoring of vendor performance. Risks to be considered include not only credit risk, but also business reputation and compliance risks associated with particular credit products. Title lenders entering into such arrangements with national banks should not assume that the benefits of a bank charter, particularly with respect to the application of state and local law, would be available to them.

This advisory letter alerts national banks to the significant risks associated with title lending. It also alerts national banks and their subsidiaries to the OCC's intention to examine carefully title-lending activities involving national banks through direct examination of the bank, examination of any title loan service provider establishing an arrangement with a national bank, and, where applicable, review of any licensing proposals involving this activity. These examinations will focus not only on safety and soundness risks, but also on compliance with applicable consumer protection and fair lending laws. The OCC may assess special examination fees on banks entering into arrangements with title lenders to cover the OCC's additional costs of conducting an examination or investigation of the bank's title loan activities as carried out through the title lender.

## BACKGROUND

Title loans are short-term (typically 30 days or less), high interest (often 25 percent or more per month) consumer loans secured by the borrower's clear automobile title. A borrower may extend the loan for a subsequent month if he or she pays the monthly interest due for the previous month. It is common that a borrower will roll over a title loan several times. If the borrower is unable to pay the monthly interest or principal that is due, the title lender takes possession of the automobile. Upon sale of the automobile, some lenders retain the proceeds of the sale even if the value of the automobile exceeds the loan amount.

Title loans contain several lending practices that have been identified as potentially abusive. Interest rates can be inordinately high and the loan terms may make it difficult or impossible for borrowers to reduce their indebtedness. In addition, title loan programs may target certain persons who are perceived to be less financially sophisticated or otherwise vulnerable to abusive loan practices. Concerns about abusive (and unlawful) lending practices are heightened when lenders fail to rebate the net proceeds to the defaulted borrower upon the sale of the automobile.

## RISK ANALYSIS

Title lending poses significant credit, strategic, reputation, compliance, and legal risk for banks. Banks must consider carefully these risks before engaging in such activity, either directly or indirectly.

### ***Credit Risk***

Title lending poses credit risks to national banks, including:

- Contractual agreements with third parties that originate, purchase or service title loans may increase the bank's credit risk due to the third party's inability or unwillingness to meet the terms of the contract. As noted in OCC Advisory Letter 2000-9, the risks from such third party arrangements "can be excessive if management and directors do not exercise appropriate due diligence prior to entering the third party arrangement, and effective oversight afterwards." The risk from the third party's failure to meet the terms of the contract also results in increased compliance, reputation, and legal risk.

- Title-loan industry estimates indicate that the loss rates for title loans exceed the loss rates for conventional loan products. The higher loss rates reflect the increased level of credit risk inherent in this product, including the undervaluation, reduction in value, or loss of the collateral. As a result, title lending raises particular concerns about concentration risk. In addition, title loans pose additional risks and costs in connection with servicing and collection activities.

- Prudent lending standards require a bank to determine the borrower's financial capacity, the value of the collateral, and the condition and location of the collateral. Some title loans are made based on the value of the collateral and not on the borrower's ability to repay the loan at its stated maturity. Such loans are inconsistent with safe and sound lending principles. Nonbank title lenders may disregard prudential lending standards and these lenders' proposed participation with banks in offering title loans will increase the risks to the banks involved.

- Title loans are generally made to borrowers with limited financial capacity or blemished or nonexistent credit histories. These loans, thus, are considered subprime loans subject to specific credit and other risks identified in the interagency and OCC guidelines on subprime lending (see OCC Bulletins 99-10, issued March 5, 1999, and 99-15, issued April 5, 1999).

- Title loans that remain on the bank's books are subject to the Uniform Retail Credit Classification and Account Management Policy, which establishes parameters for renewing credits. Title loan industry materials indicate that title loan borrowers typically renew the loans multiple times. However, unlimited renewals, multiple renewals without principal reduction, or renewals in which interest and fees are added to the principal balance are not consistent with safe and sound banking principles. Under the policy, a bank must adopt explicit standards that control the use of renewals, and the standards must be based on the borrower's willingness and ability to repay the loan. Title lending that is not subject to appropriate limitations on the number and frequency of renewals would not meet the intent and standards of the policy.

- Loans to borrowers that do not have the capacity to service their loans at maturity generally will be classified "Substandard" or worse, depending upon the value of the collateral. Further, when the borrower does not demonstrate the capacity to service the loan from sources other than the collateral pledged, the loan may be placed on non-accrual.

***Transaction Risk***

Title lending poses transaction risk for national banks, including:

- Title loans are a form of specialized lending not typically found in national banks, but are frequently originated by unregulated nonbank firms. Title loans can also be subject to high levels of transaction risk given the volume of loans originated, the handling of credit and collateral documents, and the movement of loans between the bank and a third-party purchaser. Because title loans may be underwritten off-site, there is a risk that agents or employees may misrepresent information about the loans or increase credit risk by failing to adhere to established underwriting guidelines.

***Reputation Risk***

Title lending poses reputation risks for national banks, including:

- Title lending raises significant consumer protection concerns, because of the high cost of the loan, and may involve abusive practices. Other significant consumer protection concerns are raised by the use of collection practices that permit the lender to take possession of the automobile collateral without providing the borrower the right to cure the default or to share in the net proceeds of the sale of the collateral. In addition, banks face increased reputation risk when they enter into arrangements with third parties to offer title loans with fees, interest rates, or other terms that could not be offered by the third party directly.

***Compliance and Legal Risks***

Title lending poses compliance and legal risks for national banks, including:

- Title loans are subject to consumer protection laws, including the Truth in Lending Act (TILA). Compliance risk may arise in particular title loan programs when fees and finance charges are not properly disclosed to the borrower. Compliance risk may also arise in title-lending programs involving "rental" payments for the use of the automobile that is the security for the loan. Some courts have held that these payments are finance charges under the TILA and must be included in the Annual Percentage Rate (APR), in addition to the interest rate and other fees applicable to the loan. A bank that fails to disclose correctly the APR will be required to provide restitution to consumers and can face civil penalties and class action lawsuits.

- Title loans also raise questions about a lender's compliance with applicable commercial codes in connection with obtaining and perfecting a valid security interest in the collateral and returning excess proceeds to the borrower when collateral is foreclosed.

- In cases where a bank purchases title loans from a third party, such as a broker or joint venture partner, who continues to service the loans, the aggregate of such loans may be subject to the lending limitations of 12 CFR Part 32.

**BANK SERVICE COMPANY ACT AND OTHER SUPERVISORY CONCERNS**

The OCC will treat arrangements in which title loan companies provide services in connection with the origination, servicing, and collection of title loans under agreements with national banks as subject to the provisions of the Bank Service Company Act, 12 USC 1867(c). Therefore, the performance of the third party in connection with the arrangement will be subject to examination by the OCC to the same extent as if the bank itself were performing such services on its own premises. Because of the significant credit, strategic, reputation, compliance, and legal risks posed by title lending, the OCC intends to conduct examinations of title loan companies that enter into arrangements with national banks to ensure compliance with all applicable laws and principles of safe and sound lending. Such examinations would evaluate safety and soundness risks, compliance with applicable consumer protection and fair lending laws, and whether the third party engages in unfair or deceptive acts or practices in violation of federal or applicable state law. In addition, the OCC will pursue appropriate corrective measures, including enforcement actions, to address violations of laws and regulations or unsafe or unsound practices by the bank or title loan company. Because of the risks posed, national banks that engage in title lending directly also will be subject to additional oversight.

Concurrently with the issuance of this advisory letter, the OCC is publishing in the *Federal Register* a proposal to amend its regulation on assessment of fees (12 CFR Part 8) to clarify that the OCC may assess a national bank a special examination or investigation fee when the OCC examines or investigates the activities of a third-party service provider. The OCC will conduct such special examinations or investigations if the activities conducted by the service provider for the bank present heightened risks or are of an unusual or novel nature, or when the bank has insufficient systems, controls, or personnel to adequately monitor, measure, and control the risks associated with the activity. Due to the significant level of risks to the bank posed by title lending, the OCC will assess such fees when it conducts a special examination or investigation of a title lender that provides services to a national bank.

## LICENSING CONSIDERATIONS

The OCC will scrutinize carefully any proposals submitted by national banks or organizers that intend to originate title loans, whether in their own charters, through investments in third parties, or through subsidiaries. The OCC will require an application to be submitted for any proposed investment in a company engaged in title lending. If a national bank proposes to enter into an arrangement with a title loan company that will involve the bank's subsidiary, the OCC deems that arrangement to be a new activity by the subsidiary for which an application is required. The activity is not eligible for an after-the-fact notice. In its review of, and decision on, any such application, the OCC will take into account the significant risks associated with title lending activities and arrangements with title loan companies described in this advisory letter.

Because of the risks involved, national banks should consult their supervisory office before committing to *any* arrangements described in this advisory letter or engaging in title lending activities. Questions concerning this advisory letter may be directed to the Community and Consumer Law Division at (202) 874-5750, or the Credit Risk Division at (202) 874-5170.

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**Joint Release** | **Office of the Comptroller of the Currency**
**Office of Thrift Supervision**

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# Agencies Urge Banks and Thrifts to Evaluate Risks with Vendors Engaged In Practices Viewed as Abusive To Consumers

WASHINGTON--The Office of the Comptroller of the Currency (OCC) and Office of Thrift Supervision (OTS) today alerted national banks and federal thrifts that the agencies have significant safety and soundness, compliance and consumer protection concerns with banks and thrifts entering into contractual arrangements with vendors to fund so-called “title loans” and “payday loans.”

The OCC and OTS each issued guidelines that reflect a consistent supervisory approach for addressing the risks associated with title lending and payday lending in national banks and federal thrifts.

The OCC and OTS guidance noted the agencies’ intention to carefully examine payday and title lending activities, through direct examination of banks and thrifts, and, where applicable, review of any licensing proposals involving this activity. These examinations and reviews will focus not only on safety and soundness risks, but also on compliance with applicable consumer and fair lending.

“Title loans” are short term (typically 30 days or less), small denomination loans, made at extremely high interest rates (often 25% or more per month) and secured by liens on borrowers’ titles to their automobile loans. “Payday loans” are typically short-term (until the borrower’s next payday) loans with a fee financed into the loan.

“The OCC’s and OTS’s supervisory concerns are not limited to these particular products,” said Comptroller John D. Hawke, Jr. and Director Ellen Seidman in a statement released with the supervisory guidance. “Title loans and payday loans are examples of types of products being developed by non-bank vendors who have targeted national banks and federal thrifts as delivery vehicles. These include check cashing services and ‘secured’ credit cards.”

The OCC and OTS said they have learned that non-bank vendors seeking to avoid individual state laws are approaching federally-chartered banks and thrifts urging them to enter into agreements to fund payday and title loans.

Although title and payday lenders must disclose the annual percentage rate of interest, borrowers who are frequent users of these loans do not appear to be deterred by the fact the rates or fees can be exceedingly high. Financial pressures and the lack of other less costly credit alternatives, may influence their decision to take out such loans. Because of these loans and borrower characteristics, the agencies have significant consumer protection concerns with title loans and payday lending.

The agencies noted that payday and similar short-term lending can meet a demand for short-term credit, but should be conducted only in a safe, sound and responsible manner, and with appropriate disclosures and other consumer protections. They also noted that they encourage the development of alternative and affordable forms of short-term credit.

However, they noted that they had particular concerns with the involvement of third party vendors in the promotion of payday and title loans.

"Many vendors of such products engage in practices that may be viewed as abusive to consumers," said Mr. Hawke and Ms. Seidman. "We urge national banks and federal thrifts to think carefully about the risks involved in such relationships, which can pose not only safety and soundness threats, but also compliance and reputation risks."

The two regulatory agencies said institution management should carefully weigh the possible ramifications of these types of lending and consult with their legal counsel and regulators before pursuing title or payday lending.

Depending on the nature of the agreement between an institution and a vendor, the appropriate supervisory agency may conduct an examination of the vendor and assess the bank or thrift the additional costs of conducting an examination or investigation of these title and payday loan activities.

The OCC also announced that, concurrent with its guidance on payday and title lending, the agency issued a proposal to amend its regulations to clarify that the OCC may assess a national bank a special examination or investigation fee when it examines the activities of a third party service provider. OTS already has such authority in its assessment regulations.

According to Mr. Hawke and Ms. Seidman, "vendors who have targeted national banks and federal thrifts as a means of marketing such products free from state and local consumer protection laws should not automatically assume that the benefits of the bank or thrift charter will accrue to them by virtue of such relationships, or that the OCC or OTS will defend their efforts to avoid state and local laws if challenges are raised."

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Related Links
- Joint Statement
- Advisory Letter - "Payday Lending"
- Advisory Letter - "Title Loan Programs"