

Preventing a Boom from Turning Bust: Regulators Should Turn Their Attention to Starter Interrupt Devices Before the Subprime Auto Lending Bubble Bursts

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ABSTRACT: In recent years, the subprime auto lending industry has increasingly used starter interrupt devices (“SIDs”) as a condition on loans. An SID is a technological device installed in a car that allows an auto lender to remotely disable a mortgaged car’s ignition system and, if equipped with a global positioning system, communicate the location of the car to the lender for easy repossession. Notably, however, the SID is not an indicator of a subprime borrower’s financial ability to make loan payments. The industry’s reliance on SIDs in lieu of traditional creditworthiness metrics has contributed to an increase in borrower delinquencies, and because auto lenders package and sell these risky loans to secondary market investors, the risk of default extends to other areas of the economy as well. Even though the subprime auto lending industry constitutes only a fraction of the total economy in terms of volume of credit extended, the ripple effects of a market failure could have serious repercussions for the macro economy. This Note argues that subprime auto lenders should refrain from using SIDs in their credit underwriting process and as a condition for extending credit to subprime borrowers. Further, federal and state regulators should ensure that subprime auto lenders keep their credit and underwriting functions separate from their loan servicing functions to protect individual borrowers, the auto lending industry, and the macro economy from the adverse effects of SID-infected auto loans.

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I.	INTRODUCTION.....	1189
II.	STARTER INTERRUPT DEVICES AND THE SUBPRIME AUTO MARKET: A REMNANT OF THE MORTGAGE CRISIS	1191
A.	<i>STARTER INTERRUPT DEVICES AND THE SUBPRIME AUTO LENDING INDUSTRY</i>	1191
1.	How Starter Interrupt Devices Work: Power to Auto Loan Lenders	1191
2.	Auto Dealers and Financing Choices for the Consumer	1192
3.	Subprime Auto Loan Boom: Then and Now	1195
B.	<i>MORTGAGE CRISIS: FAILED CREDIT RISK MANAGEMENT PRACTICES</i>	1197
1.	Careless Subprime Lending—a Major Cause of the Crisis.....	1197
2.	Effects of the Mortgage Crisis	1197
C.	<i>THE CURRENT LEGAL LANDSCAPE: SIDS UNDER FEDERAL REGULATIONS AND STATE LAW</i>	1199
1.	Federal Regulation of Subprime Auto Lending	1199
2.	Legality of SIDs Under State Law.....	1201
i.	<i>Category One: States with Informal Advice</i>	1204
ii.	<i>Category Two: States Statutorily Approving the Use of SIDs</i>	1205
iii.	<i>Category Three: States That Proposed but Did Not Pass Laws Regarding SIDs</i>	1207
iv.	<i>Assessing the State of the Law</i>	1207
III.	SIDS FUELING A POTENTIAL SUBPRIME AUTO “BUBBLE”	1208
A.	<i>THE VULNERABILITY OF THE SUBPRIME AUTO BORROWER</i>	1208
B.	<i>A PICTURE OF HOW SIDS ARE FUELING A SUBPRIME AUTO INDUSTRY BUBBLE</i>	1209
C.	<i>SUBPRIME AUTO LOAN INVESTMENTS AND THE ECONOMY</i>	1212
D.	<i>EVIDENCE THAT SUBPRIME AUTO LENDING PROBLEMS ARE “HEATING UP”</i>	1214
E.	<i>LACK OF STEADY SID REGULATION IS HURTING CONSUMERS</i> ..	1216
IV.	CFPB SHOULD PROVIDE TARGETED SID SUPERVISION OF SUBPRIME AUTO LENDERS AND STATES SHOULD PASS APPROPRIATE AND TARGETED REGULATIONS ON SIDS.....	1217
A.	<i>SUBPRIME AUTO LENDERS SHOULD KEEP THE SID OUT OF THEIR CREDIT DECISION MAKING PROCESS</i>	1217

B.	<i>THE CFPB SHOULD PERFORM A MORE TARGETED EXAMINATION OF SIDS FOR NONBANK “PARTICIPANTS” THAT FALL UNDER ITS SUPERVISION</i>	1219
C.	<i>STATES SHOULD PASS APPROPRIATE AND TARGETED REGULATION ON SIDS</i>	1221
V.	CONCLUSION	1222

I. INTRODUCTION

A boom in the subprime auto lending industry is making headlines. Auto lenders issued over \$145 billion in subprime auto loans in the first quarter of 2014¹ compared with only about \$120 billion in all of 2013.² Subprime auto lenders are using technology to fuel this lending boom. Specifically, they require subprime loan applicants to install starter interrupt devices (“SIDs”) in their cars as a condition of getting a car loan.³ SIDs enable the auto lender to remotely disable the ignition system of a borrower’s car if the borrower defaults. When equipped with a global positioning system (“GPS”), the SID also communicates the location of the car to the lender, facilitating repossession. Recent news reports provide evidence that the unregulated use of SIDs negatively affects subprime borrowers⁴ and their families. For example, one subprime auto lender remotely shut off a woman’s car while she was driving her ten-year-old asthmatic daughter to the emergency room.⁵

1. Michael Corkery & Jessica Silver-Greenberg, *Miss a Payment? Good Luck Moving That Car*, N.Y. TIMES: DEALBOOK (Sept. 24, 2014, 9:33 PM), <http://dealbook.nytimes.com/2014/09/24/miss-a-payment-good-luck-moving-that-car/?ref=technology>.

2. Matt Robinson et al., *Auto Loans: A Subprime Market Grows in the Shadows*, BLOOMBERG BUS. (Oct. 2, 2014), <http://www.businessweek.com/articles/2014-10-02/auto-loans-a-subprime-market-grows-in-the-shadows>.

3. Sometimes also referred to as “Payment Assurance devices.” Jeff Karg, *Choosing the Right GPS & Payment Assurance Device Provider*, AUTOMOTIVE DIG., <http://automotivedigest.com/2012/10/choosing-the-right-gps-payment-assurance-device-provider> (last visited Jan. 13, 2016).

4. “A subprime borrower is an individual with a less-than-perfect credit rating.” *Glossary: Subprime Borrower*, LENDINGTREE, <https://www.lendingtree.com/glossary/what-is-subprime-borrower> (last visited Jan. 13, 2016). Characteristics of a subprime borrower include an individual with: (1) “[a] FICO score below 660;” (2) “[t]wo or more 30-day delinquencies in the last 12 months;” (3) “[a] foreclosure in the last 24 months;” (4) “[a] bankruptcy in the last 60 months;” (5) “[d]ebt-to-income ratio of 50 percent or more;” and (6) “[t]rouble paying for month-to-month living expenses.” *Id.* FICO stands for Fair Isaac Corporation and is a company that creates credit scores. FICO “use[s] information provided by one of the three major credit reporting agencies—Equifax, Experian or TransUnion” and “uses it to create scores that help lenders predict behavior, such as how likely someone is to pay their bills on time (or not), or whether they are able to handle a larger credit line.” Gerri Detweiler, *What Does FICO Stand For? What Is a FICO Score?*, CREDIT.COM (Sept. 19, 2013), <http://www.credit.com/credit-scores/what-does-fico-stand-for-and-what-is-a-fico-credit-score>.

5. See *infra* notes 180–81 and accompanying text.

Other lenders have stranded drivers in unsafe neighborhoods, prevented parents from driving their children to school or a hospital, and deactivated cars driving on the interstate.⁶

Subprime auto lenders engage in credit underwriting in the shadow of the SID. While SIDs are unconnected with the borrower's objective creditworthiness (as measured by factors like credit history and financial status), lenders regard SIDs equally favorably because they lower the repossession risk. Use of SIDs as a substitute for creditworthiness contributes to an increased rate of subprime auto loan defaults as subprime borrowers take on car loans incommensurate with their ability to pay.⁷ Exacerbating this problem, auto lenders sell these loans to investment firms who then package the loans into high risk, high return bond securities and sell them to investors. The investors purchase these securities because they want higher returns on their investment in the current low return environment.⁸ The subprime auto lenders' improper use of the SID to justify granting car loans incommensurate to the subprime borrower's ability to pay has negative consequences that expand beyond the subprime auto loan industry to impact the economy as a whole.

Current federal and state regulations do not do enough to curb these irresponsible lending practices. At the federal level, the Consumer Financial Protection Bureau ("CFPB") passed a final rule in June 2015 that brought subprime auto lenders under its supervision, but the CFPB has not yet used its power under the final rule to ensure these lenders refrain from using SIDs as a condition of granting credit.⁹ Additionally, most states do not have regulations directly targeting SIDs and thus fail to ensure that subprime auto lenders use the SIDs in a way that does not contribute to borrower delinquency.¹⁰

6. See *infra* notes 182–84 and accompanying text.

7. See Wolf Richter, *Subprime Spikes Auto Sales, Delinquencies Soar, Industry in Total Denial, Fallout to Hit Main Street*, WOLF STREET (Jan. 9, 2015), <http://wolfstreet.com/2015/01/09/subprime-auto-loans-spike-sales-industry-in-denial-implosion-to-hit-broader-economy-more-than-banks> (noting that “[o]ver 8.4% of subprime auto loans taken out in the first quarter of 2014 were *already* delinquent by November”).

8. Robinson et al., *supra* note 2 (noting that “Wall Street sold \$17.7 billion of [bonds backed by subprime auto loans] . . . through Sept. 26 [in 2014], a pace that would make 2014 the busiest year since 2006”).

9. See *infra* notes 82–83, 192–96 and accompanying text. Congress, in the wake of the 2008 mortgage meltdown, created the CFPB as part of the Dodd–Frank Wall Street Reform and Consumer Protection Act of 2010 (“Dodd–Frank Act”). See Dodd–Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111–203, 124 Stat. 1376 (codified as amended at 12 U.S.C. §§ 5301–5641 (2012)). CFPB’s function is “to implement and enforce federal consumer financial laws in order to promote fairness, transparency, and competition in markets for consumer financial products and services.” Kim B. Perez, *The CFPB “Indirectly” Regulates Lending Through Auto Dealers*, 18 N.C. BANKING INST. 399, 401 (2014) (citing 12 U.S.C. § 5511 (2012)).

10. See *infra* Part II.C.2 (discussing current state laws regarding SIDs).

This Note argues that an SID is not an indicator of a subprime borrower's ability to fulfill the contractual payments of a car loan and therefore subprime auto lenders should not use SIDs in their credit underwriting process or as a condition for granting a subprime borrower a car loan. While SIDs benefit auto lenders by lessening their repossession risk, lenders can still reap that benefit without using the SID in the credit decision process. Part II of this Note discusses the functionality of the SID, the dangers of careless subprime lending evidenced by the recent subprime mortgage crisis, and the current state and federal regulatory regime affecting the subprime auto loan industry. Part III digs deeper into how the industry is using the SID to fuel the boom in the subprime auto loan industry through lending practices that are likely to result in increased loan defaults. Part IV recommends that subprime auto lenders keep their credit underwriting process separate from their decision about whether to use an SID and suggests an enhanced federal–state regulatory framework to enforce this recommendation—while states should continue to dictate the legality of SIDs and statutorily require lenders to maintain the recommended separation, the federal CFPB should adopt procedures so that when it examines subprime auto lenders, it ensures that the necessary separation is maintained.

II. STARTER INTERRUPT DEVICES AND THE SUBPRIME AUTO MARKET: A REMNANT OF THE MORTGAGE CRISIS

A. STARTER INTERRUPT DEVICES AND THE SUBPRIME AUTO LENDING INDUSTRY

1. How Starter Interrupt Devices Work: Power to Auto Loan Lenders

An SID is a technological device installed in cars that enables the lender to deactivate the car's ignition system remotely.¹¹ Some SIDs are also equipped with GPS, which enables lenders to determine the specific location of the car.¹² The device tracks a borrower's car payments and disables the car's ignition if the borrower defaults or the lender does not receive a payment within a grace period.¹³ Although subprime auto lenders and SID manufacturers claim that SIDs cannot shut off a car's ignition while it is mobile, several news articles note stories from borrowers who claim their cars were shut down while in operation.¹⁴

11. Corkery & Silver-Greenberg, *supra* note 1.

12. Thomas B. Hudson & Daniel J. Laudicina, *The Emerging Law of Starter Interrupt Devices*, 61 BUS. L. MAG. 843, 844 (2005); see also Peter Salinas, *Great Debate*, DEALER BUS. J. (Aug. 2006), <http://www.dealerbusinessjournal.com/articleview.php?id=639-84942> (noting that if the borrower refuses to pay, SIDs “with GPS technology can locate [the car], so long as it is not at the bottom of a parking garage or otherwise hidden from view of a GPS satellite”).

13. Hudson & Laudicina, *supra* note 12, at 843.

14. Compare HUDSON COOK, LLP, THE LAW APPLICABLE TO THE PAYMENT ASSURANCE TECHNOLOGY INDUSTRY C-1 (2013), <http://www.leg.state.nv.us/Session/77th2013/Exhibits/Assembly/CL/ACL493C.pdf> (noting that when a lender properly installs the SID, the SID

An SID consists of two main components: (1) hardware installed in the dashboard of the car; and (2) a detached remote control (i.e., physically detached from the car).¹⁵ The SID emits “flashing lights” and “beeping noises” prior to disabling the car as the payment due date gets closer.¹⁶ After each car payment, the lender enters the payment information related to the borrower’s unique SID onto the SID manufacturer’s web application, which generates a “unique code.”¹⁷ The lender then gives the borrower this payment code to enter into the SID remote control.¹⁸ Entering the payment code into the remote control “resets the [SID] to coordinate with the payment due date activating the vehicle for another payment period” and prevents the car from being immobile.¹⁹ Typically, even where a borrower misses a payment, the lender will give the borrower an “emergency code” in cases of emergency so the borrower can use the car for a stipulated period.²⁰

2. Auto Dealers and Financing Choices for the Consumer

In order to understand how and why borrowers agree to the use of an SID, it is important to consider the types of dealers and financing options available to consumers as well as the negotiating dynamics that subprime borrowers face. Auto dealers typically operate in one of three different forms: (1) franchise dealers; (2) independent dealers; and (3) “buy here, pay here”

“cannot disable a [car] in operation”), with Corkery & Silver-Greenberg, *supra* note 1 (noting that “[o]ne woman in Nevada said her car was shut down while she was driving on the freeway,” while also noting that one lender that uses SIDs stated “[i]t is impossible to cause a [car] to shut off while it is operating,” and an SID manufacturer stating that “its products were designed to prevent a car from starting, not to shut it down while it was in operation”); see also *infra* text accompanying notes 180–84.

15. *What Is a Starter Interrupt Device?*, DEAL PACK (June 27, 2012), <http://www.dealpack.com/what-is-a-starter-interrupt-device>.

16. Christopher Bucktin, *Terrified Driver Almost Crashes Car When Loan Company Hit ‘Kill Switch’ for Missing Repayments*, DAILY MIRROR (Sept. 26, 2014, 6:35 PM), <http://www.mirror.co.uk/news/technology-science/terrified-driver-crashes-car-loan-4325955>; see also Corkery & Silver-Greenberg, *supra* note 1 (noting that the beeps “become more persistent as the due date for the loan payment approaches”); Kashmir Hill, *People with Bad Credit Can Buy Cars, but They Are Tracked and Have Remote-Kill Switches*, FORBES (Sept. 25, 2014, 2:25 PM), <http://www.forbes.com/sites/kashmirhill/2014/09/25/starter-interrupt-devices> (noting that the SID “can set off a beep in the car when someone has missed a payment”).

17. *What Is a Starter Interrupt Device?*, *supra* note 15.

18. *Id.*

19. *Id.*

20. Hudson & Laudicina, *supra* note 12, at 843; see also Corkery & Silver-Greenberg, *supra* note 1 (“Borrowers are typically provided with codes that are supposed to restart the [car] for 24 hours in case of an emergency.”). However, there is some evidence that these emergency codes sometimes do not work. See Lily Hay Newman, *Lenders Can Remotely Disable Cars if People Don’t Pay Their Loan Bills*, SLATE (Sept. 25, 2014, 6:29 PM), http://www.slate.com/blogs/future_tense/2014/09/25/to_insure_subprime_auto_loans_companies_are_installing_starter_interrupt.html (noting that although “[b]orrowers are supposed to get codes that would allow them to restart their car for one day in case of emergency, but [consumers] have been reporting that the codes don’t work or that they only get one a month”).

(“BHPH”) dealers.²¹ Franchise dealers have an exclusive license with the car manufacturer to sell or lease one or more brands of cars.²² Independent dealers, on the other hand, operate independent of car manufacturers and, therefore, typically sell used cars.²³ BHPH dealers work mostly with subprime borrowers and sell older cars with very high mileage.²⁴ All three types of dealers lend to subprime borrowers. However, BHPH dealers, in particular, target subprime borrowers and charge them high interest rates alongside strict repossession rules.²⁵

A person seeking to finance the purchase of a new or used car typically has two financing options: direct auto financing or indirect auto financing.²⁶ A subprime borrower is more likely to use indirect auto financing. In direct auto financing, the borrower obtains financing for the cost of the car directly from a bank or similar financial institution.²⁷ Using direct auto financing gives the borrower flexibility in car shopping: with a budgeted loan amount, the borrower can compare cars within a given price range and use the loan as a negotiating tool with the auto dealer.²⁸

With indirect auto financing, the borrower obtains credit from an intermediary third party that is typically the auto dealer (i.e., franchise dealer, independent dealer, or BHPH dealer).²⁹ Auto dealers usually prefer that borrowers obtain financing through them because “[i]f the dealer controls the financing and has the ability to adjust the terms of that financing, then the dealer has more opportunity to sell and finance additional insurance or warranty products.”³⁰ About 80% of consumers obtain car loans through an

21. DELVIN DAVIS, CTR. FOR RESPONSIBLE LENDING, AUTO LOANS: THE STATE OF LENDING IN AMERICA & ITS IMPACT ON U.S. HOUSEHOLDS 64 (2012), <http://www.responsiblelending.org/state-of-lending/reports/4-Auto-Loans.pdf>.

22. *Id.*

23. *Id.*

24. *Id.*

25. *Id.*; see also Ashlee Kieler, *CFPB Orders ‘Buy-Here, Pay-Here’ Auto Dealer DriveTime to Pay \$8M Penalty for Unfair Debt Collection Practices*, CONSUMERIST (Nov. 19, 2014), <http://consumerist.com/2014/11/19/cfbp-orders-buy-here-pay-here-auto-dealer-drivetime-to-pay-8m-penalty-for-unfair-debt-collection-practices>.

26. DAVIS, *supra* note 21, at 65; see also Richard Cordray, *Prepared Remarks of CFPB Director Richard Cordray at the Auto Finance Field Hearing*, CONSUMER FIN. PROTECTION BUREAU (Sept. 18, 2014), <http://www.consumerfinance.gov/newsroom/prepared-remarks-of-cfpb-director-richard-cordray-at-the-auto-finance-field-hearing> (“[1] They can take out a loan or lease directly from a lender, such as a bank or an auto finance company. Or [2] they can go through an intermediary to get a loan or lease from a third-party lender, which is known as indirect auto financing.”).

27. DAVIS, *supra* note 21, at 65.

28. *Id.*

29. *Id.*

30. *Id.*

auto dealer (i.e., indirect financing);³¹ thus, the auto dealer is in effect “the creditor in virtually all car-lending transactions.”³²

In most indirect financing transactions, auto dealers end up selling their finance contracts to third-party lenders, usually banks, for cash flow and liquidity reasons.³³ Franchise dealers, for example, “typically enter into credit contracts that they sell to banks, finance companies, and credit unions within days of the transactions.”³⁴ Independent auto dealers sell a majority of their indirect loans to captive finance companies³⁵—businesses “whose primary [purpose] is to finance the purchase of a specific manufacturer’s automobiles.”³⁶ BHPH dealers, however, usually keep their credit contracts in-house rather than selling them.³⁷ It has been the practice of BHPH dealers to focus on recouping their investments directly from the borrower by charging high interest rates and repossessing the car “at the first sign of delinquency.”³⁸

Consumers who rely on indirect financing have less bargaining power than consumers with direct financing who can use their loan to negotiate a lower price because of the external cap on their budget. This is true because when the dealer controls the amount and terms of the loan, the dealer controls the cap on the borrower’s budget. Consumers with weakened bargaining power, “especially subprime customers with few, if any, other financing options, often are at the mercy of the dealer.”³⁹ Dealers are thus in a position to add conditions to a loan or to bombard consumers with additional products, pressuring the consumer to decide “in a matter of minutes” whether to purchase the products or which options to take.⁴⁰

31. Cordray, *supra* note 26.

32. DAVIS, *supra* note 21, at 65.

33. *Id.* (indicating that dealers usually sell their finance contracts to a third party so the dealer can use the cash received from the sale to pay the money the dealer owes for keeping cars on their lots).

34. *Id.* at 64.

35. *Id.* at 66.

36. CONSUMER FIN. PROT. BUREAU, CFPB BULLETIN 2013-02, at 1 (2013), http://files.consumerfinance.gov/f/201303_cfpb_march_-Auto-Finance-Bulletin.pdf; see also Cordray, *supra* note 26 (“[C]aptive’ finance companies, owned by the automotive manufacturers themselves, focus on indirect financing. Many captives provide consumers with financing for the primary purpose of facilitating sales for their parent companies and associated dealers.”).

37. DAVIS, *supra* note 21. This fact helps mitigate the impact of defaulting SID-infected subprime car loans on the market.

38. *Id.* at 73–74.

39. *Id.* at 66.

40. *Id.*

3. Subprime Auto Loan Boom: Then and Now

Auto loans to subprime borrowers have increased dramatically since 2008.⁴¹ Measuring the percentage of subprime auto loans relative to overall auto loans, the percentage of used car loans that franchise auto dealers made to subprime borrowers between 2009 and 2014 saw an increase from 17% to approximately 25.4%.⁴² Also, new car sales to subprime borrowers in 2014, across all dealership types, increased close to 14%, which was comparably at the level of similar sales that existed in 2006 and 2007.⁴³ Subprime auto lending “reached a seven-year high in March 2014 at \$13.1 billion, the highest level since March 2007[, which is] close if not equal to pre-crisis levels.”⁴⁴ In the third quarter of 2014, measuring the percentage of open auto loans, subprime borrowers held 39% (worth \$337 billion) of such loans compared to \$304 billion and \$255 billion in 2013 and 2012 respectively.⁴⁵ Since then, subprime auto debt has decreased,⁴⁶ but there is no strong evidence that this decrease is here to stay. This is especially concerning because there is no evidence that subprime auto lending practices are changing for the better.

An improper use of SIDs could contribute to a burst in the subprime auto market. From a credit risk perspective, lenders’ and dealers’ reliance on the installation of SIDs appears to be playing a significant role in the credit decision process.⁴⁷ Auto dealers and lenders have installed SIDs in about two million cars in the U.S., fueling the boom in the subprime auto market.⁴⁸ Today, a subprime borrower who may not be able afford a specific monthly

41. *Id.* at 69; see also Alice Holbrook, *Is There a Subprime Auto Loan Bubble?*, USA TODAY (Sept. 27, 2014, 8:18 AM), <http://www.usatoday.com/story/money/personalfinance/2014/09/27/subprime-auto-loan/16272641> (noting that “[a]ccording to the Federal Reserve Bank of New York” auto loans to subprime borrowers “ha[ve] nearly doubled since 2009—a much greater increase than in any other loan type”).

42. AMY S. MARTIN & MARK M. RISI, STANDARD & POOR’S RATINGS SERVS., AS SUBPRIME AUTO LENDING HEATS UP, ABS TRANSACTIONS REMAIN ADEQUATELY PROTECTED AGAINST INCREASING CREDIT RISK 3 (2014).

43. *Id.* at 4–5.

44. *Id.* at 5.

45. Ben Geier, *Can Subprime Auto Loans Crash the Financial System?*, FORTUNE (Jan. 13, 2015, 6:09 PM), <http://fortune.com/2015/01/13/subprime-auto-loans>.

46. Bloomberg reported that as of the first quarter of 2015, subprime auto loan debt was \$178 billion representing 19.7% of all auto loan debt. Jody Shenn & Matt Scully, *Subprime Auto-Loan Titan Defends Longer Terms as New Normal*, BLOOMBERG BUS. (July 20, 2015, 4:29 PM), <http://www.bloomberg.com/news/articles/2015-07-20/subprime-auto-lending-veteran-calls-longer-maturities-new-normal>.

47. See Corkery & Silver-Greenberg, *supra* note 1 (noting that SIDs “are helping feed the subprime boom” and that “without them . . . millions of Americans might not qualify for a car loan at all”).

48. Sydney Ember, *Morning Agenda: Devices Fuel Subprime Auto Boom*, N.Y. TIMES: DEALBOOK (Sept. 25, 2014, 7:33 AM), http://dealbook.nytimes.com/2014/09/25/morning-agenda-devices-fuel-subprime-auto-boom/?_php=true&_type=blogs.

loan payment on a car can still purchase that car as long as the consumer agrees to the installation of the SID.⁴⁹

Combined with the fact that auto lenders package the subprime loans into asset-backed securities (“ABS”)⁵⁰ issuance of which “has grown considerably in the past two years,”⁵¹ there are clear parallels between this auto boom and the housing boom that precipitated the mortgage crisis.⁵² It is fair for economic analysts to note that because the current boom in subprime auto lending affects a smaller market than the boom in the mortgage market did, a market failure would have somewhat less catastrophic effects.⁵³ The fact that the size and asset structures of the two industries are distinct is equally true. But it is not sound credit risk management to tolerate a risky practice just because it is unlikely to cause a crisis to the same unprecedented degree as the mortgage meltdown. The subprime mortgage crisis taught us the importance of aligning the amount of credit a borrower receives to the amount that the borrower can afford. This lesson extends beyond the strict confines of the subprime mortgage market and applies with force here. The next Subpart examines the lessons of the mortgage crisis to illustrate the dangers that irresponsible subprime lending practices can pose across sectors of the economy.

49. See *infra* notes 144–45 and accompanying text.

50. “Asset-backed securities . . . are created by buying and bundling loans—such as residential mortgage loans, commercial loans or student loans—and creating securities backed by those assets, which are then sold to investors. Often, a bundle of loans is divided into separate securities with different levels of risk and returns. Payments on the loans are distributed to the holders of the lower-risk, lower-interest securities first, and then to the holders of the higher-risk securities.” *Asset-Backed Securities*, U.S. SEC. & EXCHANGE COMMISSION (Oct. 23, 2014), <http://www.sec.gov/spotlight/dodd-frank/assetbackedsecurities.shtml>.

51. DAVIS, *supra* note 21, at 69; see also Holbrook, *supra* note 41 (recognizing the fact that subprime auto loans are converted into risk securities, and further stating that “[w]e’ve seen a lot of Wall Street money chasing these loans” (quoting John Van Alst, attorney for the National Consumer Law Center)).

52. See *infra* Part II.B.2.

53. See Holbrook, *supra* note 41 (“The overall size of the auto loan market is less than one-tenth of the overall size of the mortgage market . . . I can’t imagine the same economy-shaking consequences that the collapse of subprime mortgage lending had.” (quoting Lawrence White, economics professor at the Stern School of Business at New York University)). But see Geier, *supra* note 45 (“Those who have expressed concern about the auto lending market have reasons for that concern . . . Underwriting standards in the subprime market have deteriorated, while practices in the market, like interest rate markup and the sale of add-on products, can make loans unaffordable.” (quoting Chris Kukla, senior vice president of the Center for Responsible Lending)).

B. MORTGAGE CRISIS: FAILED CREDIT RISK MANAGEMENT PRACTICES

1. Careless Subprime Lending—a Major Cause of the Crisis

The mortgage crisis was a result of a combination of factors, with subprime lending playing a significant role.⁵⁴ The crisis started in 2001 when the U.S. housing industry experienced an abrupt increase in the value of real estate assets to a point where consumer income to support the increase in value simply did not exist for many people.⁵⁵ Economic experts called this the “housing bubble.”⁵⁶ This bubble resulted in an increase in homeownerships, many of which went to subprime borrowers.⁵⁷ The housing bubble reached its peak in 2005, followed by “decreases in home prices and mortgage debt . . . higher than the value of the property.”⁵⁸

Irresponsible credit underwriting practices played a major role in creating the bubble—lenders looked beyond traditional measures of creditworthiness when granting credit to high risk borrowers.⁵⁹ These borrowers became unable to make their mortgage payments and, unable to refinance, many defaulted on their loans.⁶⁰ These bad loans were packaged into complex financial instruments that lenders sold in secondary markets.⁶¹ As a result, when the subprime loans went bad, the negative effects of subprime lending rippled throughout the economy.⁶²

2. Effects of the Mortgage Crisis

The subprime mortgage meltdown became a national and global financial crisis as the increase in mortgage defaults and home foreclosures that began in 2006 escalated through 2007, exacerbated by plummeting home prices.⁶³ The effects were catastrophic. In 2008, the International Monetary Fund estimated that the crisis caused a total loss of about \$945

54. See KATALINA M. BIANCO, THE SUBPRIME LENDING CRISIS: CAUSES AND EFFECTS OF THE MORTGAGE MELTDOWN 3 (2008) (“Many experts and economists believe [the crisis] came about though [sic] the combination of a number of factors in which subprime lending played a major part.”).

55. *Id.*

56. *Id.*

57. *Id.* at 6 (noting that “[t]he share of subprime mortgages to total originations increased from 9 percent in 1996 to 20 percent in 2006 according to Forbes,” and that “[s]ubprime mortgages totaled \$600 billion in 2006, accounting for approximately one-fifth of the U.S. home loan market”).

58. *Id.* at 3.

59. See *id.* at 6–8.

60. *Id.* at 10.

61. See *id.* at 8–9.

62. See *id.* at 12 (indicating that with high risk borrowers being underwater and unable to make their mortgage payments, foreclosure filing spiked, ultimately resulting in “collapse of the subprime mortgage industry”).

63. *Id.* at 2.

billion in the U.S.⁶⁴ Major U.S. financial institutions reported massive losses: In 2007, Citigroup and Merrill Lynch reported losses of \$23.8 billion and \$24.7 billion respectively.⁶⁵ Other bank losses in the same year included “Bank of America (\$9.7 billion), Morgan Stanley (\$10.3 billion), JP Morgan (\$5.3 billion), and Bear Stearns (\$2.6 billion).”⁶⁶ Nontraditional financial institutions, like hedge funds and insurances companies, also took a hit of about \$100 billion.⁶⁷

At the heart of the mortgage crisis were subprime mortgages in default. Because the subprime loans were packaged into financial instruments in the secondary market, the increase in mortgage defaults and home foreclosures caused a slew of unintended consequences beyond the financial industry. The crisis “caused a drop in cities’ revenues, a spike in crime, more homelessness and an increase in vacant properties.”⁶⁸ It negatively affected consumer spending and shook not only the U.S. stock market, but markets around the world.⁶⁹ Five years post-crisis, the U.S. and European economies continue to feel its effects.⁷⁰

The ill-effects of the mortgage crisis were possible because lenders made loans to borrowers without properly assessing the borrowers’ ability to repay the loans. Using SIDs as a condition to grant credit reflects remnants of the same irresponsible lending practices that brought about the mortgage crisis. Similar to the mortgage crisis, at the heart of the subprime auto loan boom are lenders who look beyond traditional measures of credit when making subprime loans. If these loans were to go into default on a massive scale, perhaps caused by a general economic downturn, the subprime auto loan bubble burst would cause a slew of unintended consequences. People could lose jobs, their credit histories would worsen, cars could stall on the freeway, and people might not be able to leave for the hospital in an emergency.

64. *Id.*

65. FIN. CRISIS INQUIRY COMM’N, THE FINANCIAL CRISIS INQUIRY REPORT: FINAL REPORT OF THE NATIONAL COMMISSION ON THE CAUSES OF THE FINANCIAL AND ECONOMIC CRISIS IN THE UNITED STATES 256 (2011), <http://www.gpo.gov/fdsys/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf>.

66. *Id.*

67. *Id.*

68. Haya El Nasser, *Foreclosure Crisis Has Ripple Effect*, USA TODAY (Mar. 11, 2008, 12:08 AM), http://usatoday30.usatoday.com/news/nation/2008-03-11-foreclosures_N.htm.

69. BIANCO, *supra* note 54, at 2, 13.

70. See Paul Davidson, *Economy Is Still Bruised Five Years After Crisis*, USA TODAY (Sept. 11, 2013, 12:32 PM), <http://www.usatoday.com/story/money/business/2013/09/10/economy-2008-financial-crisis-lehman/2789841> (noting that “the vestiges of the financial crisis and recession continue to restrain growth, leaving lenders more tight-fisted, businesses more hesitant to hire and invest, and consumers less inclined to splurge”); see also James Crisp, *Europe’s Markets Still Feeling Effects of Financial Crisis*, EURACTIV.COM (Apr. 29, 2014, 2:12 PM), <http://www.euractiv.com/sections/euro-finance/europes-markets-still-feeling-effects-financial-crisis-301809> (“Europe’s financial markets are still feeling the effects of the crisis despite progress towards greater stability . . .”).

Indeed, many of these negative effects are already happening. It should not take a financial crisis to address them.

Before looking at how SIDs are fueling a subprime auto loan bubble that could burst and bring about a slew of unintended consequences, this Note will first provide an overview of federal and state regulations affecting SIDs.

C. *THE CURRENT LEGAL LANDSCAPE: SIDS UNDER FEDERAL REGULATIONS AND STATE LAW*

SIDs are currently governed by both federal and state law.⁷¹ At the federal level, the CFPB uses its authority to supervise nonbank consumer lending to enforce compliance with federal law and obtain information about a lender's internal systems and the risks posed to consumers.⁷² The Federal Trade Commission ("FTC") regulates trade practices and collection activities to protect against deceptive practices. States have authority to legislatively approve or ban the use of SIDs and to impose state-specific regulations.⁷³ In order to understand the recommendations presented in Part IV, it is important to first examine the current legal landscape affecting SIDs at the federal and state levels.

1. Federal Regulation of Subprime Auto Lending

Of the many federal laws, regulations, and agencies that protect consumers in the financial marketplace,⁷⁴ two agencies impose the greatest check on the activities of subprime auto lenders: the CFPB and the FTC. Congress created the CFPB in the wake of the subprime mortgage crisis under the Dodd–Frank Act.⁷⁵ Among its many functions, the CFPB regulates any “Consumer Financial Product or Service” that a “Covered Person” offers.⁷⁶ The Dodd–Frank Act defines a “covered person” as “any person that engages in offering or providing a consumer financial product or service; and . . . any affiliate of a person [engaged in offering or providing a consumer financial product or service] if such affiliate acts as a service provider to such person.”⁷⁷ Specifically, the CFPB “has the authority to supervise nonbank covered persons of all sizes in the residential mortgage, private education lending, and

71. This Note will not focus on whether or not SIDs are legal under state or federal laws. Rather, it argues that auto loan regulators should be more proactive in the subprime auto industry in ensuring that decisions about whether to use SIDs to protect repossession rights in the event of default are kept separate from decisions about whether to grant credit.

72. See *infra* Part II.C.1.

73. See *infra* Part II.C.1.

74. See *Consumer Protection Laws*, FED. RESERVE CONSUMER HELP, <https://www.federalreserveconsumerhelp.gov/learnmore/consumer-protection-laws.cfm> (last visited Jan. 13, 2016) (listing various federal consumer protection laws and corresponding agencies).

75. See *supra* note 9.

76. Karoline E. Andris & Kenneth J. Rojc, *Automotive Finance: Impact of the Dodd-Frank Act*, 67 BUS. LAW. 597, 598 & n.8 (2011) (citing Dodd–Frank Act § 1011(a), 12 U.S.C. § 5491(a) (Supp. IV 2010)).

77. 12 U.S.C. § 5481(6) (2012).

payday lending markets. In addition, [it] has the authority to supervise nonbank ‘larger participant[s]’ in markets for other consumer financial products or services” as the CFPB defines by rule.⁷⁸

The CFPB passed rules that define a “larger participant” in the Consumer Reporting Market,⁷⁹ the Consumer Debt Collection Market,⁸⁰ and the Student Loan Servicing Market.⁸¹ On June 10, 2015, the CFPB published final rules defining “larger participant” in the automobile financing market as “a . . . person [who] has at least 10,000 aggregate annual originations.”⁸² The final rule became effective 60 days after it was published in the Federal Register.⁸³ With this recent change, subprime auto lenders who make more than 10,000 loans per year fall within the scope of federal supervision and are subject to federal oversight from a risk perspective.⁸⁴

Once an institution fits the CFPB’s “larger participant” definition, the CFPB has the authority to conduct examinations on the institution to “(1) [a]ssess[] compliance with Federal consumer financial law; (2) obtain[] information about such [institution’s] activities and compliance systems or procedures; and (3) detect[] and assess[] risks to consumers and [to the]

78. Defining Larger Participants in Certain Consumer Financial Product and Service Markets, 77 Fed. Reg. 9592, 9593 (Feb. 17, 2012) (codified at 12 C.F.R. pt. 1090) (noting that defining who a “larger participant” is “would establish, in part, the scope of coverage of the Bureau’s supervision authority for nonbank covered persons”).

79. *See generally* Defining Larger Participants of the Consumer Reporting Market, 77 Fed. Reg. 42,874 (July 20, 2012) (codified at 12 C.F.R. pt. 1090).

80. *See generally* Defining Larger Participants of the Consumer Debt Collection Market, 77 Fed. Reg. 65,775 (Oct. 31, 2012) (codified at 12 C.F.R. pt. 1090).

81. *See generally* Defining Larger Participants of the Student Loan Servicing Market, 78 Fed. Reg. 73,383 (Dec. 6, 2013) (codified at 12 C.F.R. pt. 1090).

82. RICHARD CORDRAY, CONSUMER FIN. PROT. BUREAU, DEFINING LARGER PARTICIPANTS OF THE AUTOMOBILE FINANCING MARKET AND DEFINING CERTAIN AUTOMOBILE LEASING ACTIVITY AS A FINANCIAL PRODUCT OR SERVICE 115 (2015), http://files.consumerfinance.gov/f/201506_cfpb_defining-larger-participants-of-the-automobile-financing-market-and-defining-certain-automobile-leasing-activity-as-a-financial-product-or-service.pdf; *CFPB to Oversee Nonbank Auto Finance Companies: Bureau Publishes Exam Procedures for Supervised Companies in \$900 Billion Market*, CONSUMER FIN. PROTECTION BUREAU (June 10, 2015), <http://www.consumerfinance.gov/newsroom/cfpb-to-oversee-nonbank-auto-finance-companies> (“[The new] rule extends [CFPB’s] supervision to any nonbank auto finance company that makes, acquires, or refinances 10,000 or more loans or leases in a year.”).

83. *CFPB to Oversee Nonbank Auto Finance Companies*, *supra* note 82; *see also* Defining Larger Participants of the Automobile Financing Market and Defining Certain Automobile Leasing Activity as a Financial Product or Service, 80 Fed. Reg. 37,496, 37,498 (June 30, 2015) (codified at 12 C.F.R. pts. 1001, 1090).

84. *CFPB to Oversee Nonbank Auto Finance Companies*, *supra* note 82 (“[T]he Bureau estimates that it will have authority to supervise about 34 of the largest nonbank auto finance companies and their affiliated companies that engage in auto financing. These companies together originate around 90 percent of nonbank auto loans and leases, and in 2013 provided financing to approximately 6.8 million consumers.”); *see also* Defining Larger Participants of the Automobile Financing Market and Defining Certain Automobile Leasing Activity as a Financial Product or Service, 79 Fed. Reg. 60,762, 60,762 (Oct. 8, 2014) (to be codified at 12 C.F.R. pts. 1001 & 1090) [hereinafter *Defining Larger Participants of Automobile Financing 2014*].

consumer financial markets.”⁸⁵ As applied to subprime auto lenders, the CFPB now has the authority to, for example, review the lender’s activities, processes, and procedures to ensure they are in compliance with the Truth in Lending Act and the Fair Credit Reporting Act.

Another federal consumer protection agency is the FTC which, among its many functions, has “authority over deceptive trade practices and debt collection activities” of auto credit providers.⁸⁶ The FTC brings enforcement actions against auto credit providers for deceptive practices, making sure auto lenders provide consumers with accurate information. Pursuant to the Dodd-Frank Act, the FTC also gathers “information on possible consumer protection issues that may arise in the sale, financing or lease of [cars] through a series of roundtables and by seeking public comments.”⁸⁷ Additionally, the Department of Justice (“DOJ”) supports the “enforcement of fair lending laws.”⁸⁸ For example, if a subprime auto lender told a borrower, falsely, that an SID could not shut off a car while the car was in motion, then the consumer could file a complaint with the FTC who could bring an enforcement action with the DOJ against the auto credit provider for violating disclosure requirements associated with the use of the SID.

These federal agencies, together with the DOJ, provide general oversight and enforce broadly applicable consumer finance laws to which auto lenders must comply. However, federal regulations do not provide any direct guidance relating to the use of SIDs by auto dealers and lenders. In fact, the FTC indicates that use of “Electronic Disabling Devices” depends on the contract the borrower has with the lender and the respective state law.⁸⁹ These state laws are addressed in Part II.C.2, but as indicated below, many states do not directly address the use of SIDs.

2. Legality of SIDs Under State Law

State law governs the use of SIDs and their legality. Although SIDs have existed for a decade,⁹⁰ several states⁹¹ have not openly declared the validity of their use.⁹² Additionally, there is currently no state court that has directly dealt

85. Defining Larger Participants of Automobile Financing 2014, 79 Fed. Reg. at 60,763.

86. Kevin M. McDonald & Kenneth J. Rojc, *Automotive Finance: Shifting into Regulatory Overdrive*, 69 BUS. LAW. 599, 599 (2014).

87. *The Auto Marketplace*, FED. TRADE COMMISSION, <http://www.ftc.gov/news-events/media-resources/consumer-finance/auto-marketplace> (last visited Jan. 13, 2016).

88. McDonald & Rojc, *supra* note 86, at 599.

89. *Consumer Information: Vehicle Repossession*, FED. TRADE COMMISSION, <http://www.consumer.ftc.gov/articles/0144-vehicle-repossession> (last visited Jan. 13, 2016) (noting that “[d]epending on [the borrower’s] contract with the lender and [the borrower’s] state’s laws, [a lender’s use of an SID] may be considered the same as a repossession or a breach of the peace”).

90. Hill, *supra* note 16.

91. See *infra* Part II.C.2.

92. See Aimee Picchi, *Why the Repo Man Can Remotely Shut Off Your Car Engine*, CBS NEWS: MONEYWATCH (Sept. 25, 2014, 12:37 PM), <http://www.cbsnews.com/news/why-the-repo-man>

with the issue of whether SIDs are legal under state law.⁹³ In general, however, the Uniform Commercial Code (“UCC”) section 9-609 includes a “self-help”⁹⁴ repossession provision that permits a secured creditor,⁹⁵ in case of debtor default, to take possession of the collateral “(1) pursuant to judicial process; or (2) without judicial process, if it proceeds without breach of the peace.”⁹⁶ Separate from this right to actually repossess the collateral (in the case of SIDs, the car), the UCC allows the creditor to render the collateral unusable—usually as it relates to “heavy equipment [that] may be impractical or unduly expensive” to move.⁹⁷

All 50 states and the District of Columbia have adopted UCC section 9-609 or some version of it.⁹⁸ Additionally, most states “grant consumers a right

can-remotely-shut-off-your-car-engine (noting that SIDs “*appear* to be legal in most of the country,” and only Wisconsin “appears to have openly frowned on the practice” (emphasis added)).

93. *Id.*; see also HUDSON COOK, LLP, *supra* note 14, at C-2 (“Since the inception of the starter interrupt device, the courts have not directly addressed starter interrupt devices in reported decisions.”).

94. For a brief history of “self-help” in the repossession context, see Craig Dolly, *The Electronic Self-Help Provisions of UCITA: A Virtual Repo Man?*, 33 J. MARSHALL L. REV. 663, 668–72 (1999); and Ryan McRobert, *Defining “Breach of the Peace” in Self-Help Repossessions*, 87 WASH. L. REV. 569, 571–78 (2012). For a general overview of the traditional “self-help” remedies under the UCC, see R. Walker Humphrey, *The Creditor’s Guide to the Technology Galaxy: The Effect of Technology on Article 9 and Remotely Disabling Collateral*, 3 CHARLESTON L. REV. 665, 670–73 (2009).

95. “A secured creditor [is] an individual or business that [has] a claim against a debtor . . . by [way of] a lien on the debtor’s property. A secured creditor has security from the [debtor’s] default, and from minimizing amount that can be collected by other creditors. . . . The property that is subjected to a lien is the secured creditor’s collateral.” *Secured Creditor Law & Legal Definition*, USLEGAL, <http://definitions.uslegal.com/s/secured-creditor> (last visited Jan. 13, 2016).

96. U.C.C. § 9-609 (AM. LAW. INST. & UNIF. LAW COMM’N 2010); see also HUDSON COOK, LLP, *supra* note 14, at C-3 (citing U.C.C. § 9-609 (AM. LAW. INST. & UNIF. LAW COMM’N 2010)). For an argument that use of SIDs is equivalent to traditional repossessions, see *id.* at C-2 to C-4. Additionally, for a look into what constitutes “breach of the peace,” see generally McRobert, *supra* note 94.

97. HUDSON COOK, LLP, *supra* note 14, at C-3 (citing U.C.C. § 9-609 cmt. 6 (AM. LAW. INST. & UNIF. LAW COMM’N 1977)).

98. See ALA. CODE § 7-9A-609(a)–(b) (2006) (“After default, a secured party: (1) may take possession of the collateral; and (2) without removal, may render equipment unusable A secured party may [so] proceed . . . (1) pursuant to judicial process; or (2) without judicial process, if it proceeds without breach of the peace.”); ALASKA STAT. § 45.29.609(a)–(b) (2014) (“After default, a secured party (1) may take possession of the collateral; and (2) without removal, may render equipment unusable A secured party may [so] proceed . . . (1) in accordance with judicial process; or (2) without judicial process if it proceeds without breach of the peace.”); ARIZ. REV. STAT. ANN. § 47-9609(a)–(b) (2005) (“After default, a secured party: 1. [m]ay take possession of the collateral; and 2. [w]ithout removal, may render equipment unusable A secured party may [so] proceed . . . 1. [p]ursuant to judicial process; or 2. [w]ithout judicial process, if it proceeds without breach of the peace.”); accord ARK. CODE ANN. § 4-9-609 (2001); CAL. COM. CODE § 9609 (West 2002); COLO. REV. STAT. § 4-9-609 (2001); CONN. GEN. STAT. § 42a-9-609 (2014); DEL. CODE ANN. tit. 6, § 9-609 (2013); D.C. CODE § 28:9-609 (2001); FLA. STAT. § 679.609 (2013); GA. CODE ANN. § 11-9-609 (2002); HAW. REV. STAT. § 490:9-609 (2008); IDAHO CODE § 28-9-609 (2013); 810 ILL. COMP. STAT. 5/9-609 (2009); IND. CODE ANN. § 26-1-9.1-609 (West 2003); IOWA CODE § 554.9609 (2015); KAN. STAT. ANN. § 84-9-609 (Supp. 2014); KY. REV. STAT. ANN. § 355.9-609 (West 2006); LA. REV. STAT. ANN. § 10:9-609 (2012); ME. REV.

to cure a default before a secured party may repossess collateral.”⁹⁹ Thus, proponents of SIDs and their use in the car repossession arena argue that although a creditor’s use of the SID does not result in the physical repossession of the car, the UCC permits its usage because the creditors are simply rendering the car unusable.¹⁰⁰ The statutory rights permitting creditors to disable the collateral “suggest[] that there is no public policy against the use of [SIDs].”¹⁰¹ The nature of the law on SIDs amongst these states can be grouped into three main categories: (1) states that have not yet codified statutes that approve or restrict the use of SIDs, but instead have given informal advice surrounding the legality of SIDs;¹⁰² (2) states that have codified statutes that clearly indicate SIDs are legal under certain restrictions

STAT. tit. 9-A, § 5-112 (2014); MD. CODE ANN., COM. LAW § 9-609 (West 2013); MASS. GEN. LAWS ch. 106, § 9-609 (2012); MICH. COMP. LAWS § 440.9609 (2011); MINN. STAT. § 336.9-609 (2014); MISS. CODE ANN. § 75-9-609 (2002); MO. REV. STAT. § 400.9-609 (Supp. 2013); MONT. CODE ANN. § 30-9A-609 (2013); NEB. REV. STAT. § 9-609 (2001); NEV. REV. STAT. ANN. § 104.9609 (West 2013); N.H. REV. STAT. ANN. § 382-A:9-609 (2002); N.J. STAT. ANN. § 12A:9-609 (West 2004); N.M. STAT. ANN. § 55-9-609 (West 2003); N.Y. U.C.C. LAW § 9-609 (McKinney 2002); N.C. GEN. STAT. § 25-9-609 (2010); N.D. CENT. CODE § 41-09-106 (2001); OHIO REV. CODE ANN. § 1309.609 (West 2004); OKLA. STAT. tit. 12A, § 1-9-609 (2011); OR. REV. STAT. § 79.0609 (2013); 13 PA. CONS. STAT. § 9609 (2002); 6A R.I. GEN. LAWS § 9-609 (2001); S.C. CODE ANN. § 37-5-112 (2015); S.D. CODIFIED LAWS § 57A-9-609 (2012); TENN. CODE ANN. § 47-9-609 (2001); TEX. BUS. & COM. CODE ANN. § 9.609 (West 2011); UTAH CODE ANN. § 70A-9A-609 (LexisNexis 2009); VT. STAT. ANN. tit. 9A, § 9-609 (2001); VA. CODE ANN. § 8.9A-609 (2015); WASH. REV. CODE § 62A.9A-609 (2014); W. VA. CODE ANN. § 46-9-609 (West 2007); WIS. STAT. § 409.609 (2014); WYO. STAT. ANN. § 34-1-9-609 (2013).

99. HUDSON COOK, LLP, *supra* note 14, at C-6; *see, e.g.*, IOWA CODE § 537-5110(1), (2)(a), (3) (2015) (noting that a creditor can enforce a debtor’s obligations under a consumer credit transaction only after the creditor “give[s] the consumer [a] notice of right to cure” if the “consumer has a right to cure the default,” but otherwise cannot commence any legal action against the debtor or repossess the underlying collateral. “A consumer has a right to cure the default unless, in other than an insurance premium loan transaction, the creditor has given the consumer a proper notice of right to cure with respect to a prior default which occurred within three hundred sixty-five days of the present default, or the consumer has voluntarily surrendered possession of goods that are collateral and the creditor has accepted them in full satisfaction of any debt owing on the transaction in default.”); KAN. STAT. ANN. § 16a-5-111(2) (2008) (“[A]fter a default consisting only of the consumer’s failure to make a required payment in a consumer credit transaction payable in installments, a creditor may neither accelerate maturity of the unpaid balance of the obligation nor take possession of collateral because of that default until 20 days after a notice of the consumer’s right to cure”); ME. REV. STAT. tit. 9-A, § 5-111(1) (2009) (“With respect to a consumer credit transaction . . . after a default consisting only of the consumer’s failure to make a required payment, a creditor, because of that default, may neither accelerate maturity of the unpaid balance of the obligation, nor take possession of or otherwise enforce a security interest in goods that are collateral until 14 days after a notice of the consumer’s right to cure”); 6 R.I. GEN. LAWS § 51-3(b) (2014).

100. *See* HUDSON COOK, LLP, *supra* note 14, at C-3 (arguing that “the use of [an SID] is not a repossession of a [car], but simply the rendering a [car] unusable. The creditor has not taken possession of the collateral but the debtor no longer has the ability to start the [car]”).

101. *Id.* at C-4.

102. States issuing informal advice but not passing statutes include Iowa, Kansas, Maine, Missouri, Maryland, and Wisconsin. *See infra* Part II.C.2.i.

and conditions;¹⁰³ and (3) states that proposed a bill either approving (under certain conditions) or prohibiting the use of SIDs but failed to pass that bill.¹⁰⁴

i. Category One: States with Informal Advice

In the first category, three states through their agencies have issued informal guidance approving of the use of SIDs with restrictions: Iowa, Maryland, and Missouri. The Consumer Protection Division of the Iowa Department of Justice, for example, provided informal advice on SIDs noting:

In our view, it does not violate Iowa law to install the device pursuant to the terms stated in your correspondence providing that it does not interrupt the [car]’s starter under any circumstance prior to expiration of the 10-day period necessary for a consumer to be in default, plus the actual 20-day period during which the consumer has a right to cure the default.¹⁰⁵

In 2006, the Maryland Department of Labor, Licensing, and Regulation issued an informal opinion that also indicated its tolerance of SIDs as long as “all required notices both prior to and after repossession are properly delivered to the consumer.”¹⁰⁶ The Missouri Department of Economic Development considers “disabling a [car to] have the same effect as repossession and would thus require notice of default and a right to cure under Missouri law.”¹⁰⁷

Two states have expressed concern over the use of SIDs but have approved their use nonetheless—Kansas and Maine. Both the Kansas Office of the State Bank Commissioner and the Maine Office of Consumer Credit Regulation have expressed safety concerns¹⁰⁸ surrounding the use of SIDs but have issued informal advice that appears to indicate SIDs are legal so long as creditors comply with the debtor’s right to cure.¹⁰⁹

One state—Wisconsin—has clearly indicated that SIDs are not welcome. Although not formally codified in its statutes, Wisconsin appears to give a clear “red light” prohibition to the use of SIDs. The Wisconsin Office of Consumer Affairs issued an informal memo noting that an SID constitutes “an unfair collection practice under the Consumer Act.”¹¹⁰ Wisconsin believes

103. States statutorily indicating that SIDs are legal under certain conditions include Colorado, Connecticut, California, and Michigan. *See infra* Part II.C.2.ii.

104. States that have proposed but not passed bills approving or prohibiting the use of SIDs include Nevada and New York. *See infra* Part II.C.2.iii.

105. HUDSON COOK, LLP, *supra* note 14, at C-7 (quoting the Consumer Protection Division of the Iowa Department of Justice).

106. *Id.* (quoting the Maryland Department of Labor, Licensing, and Regulation).

107. *Id.*

108. For example, “a consumer could be stranded in unsafe circumstances by virtue of the inability to restart a [car].” *Id.*

109. *Id.* at C-6 to C-7.

110. *Id.* at C-9.

that SIDs “are an invasion of privacy and are dangerous,” and their use “constitutes ‘an improper repossession.’”¹¹¹

ii. *Category Two: States Statutorily Approving the Use of SIDs*

The second category represents states that have codified statutes approving SIDs or similar devices under certain conditions. Colorado and Connecticut have statutes modeled on UCC section 9-609. California and Michigan take another approach.

Colorado’s version of UCC section 9-609 places limits on the use of an electronic device that renders collateral unusable.¹¹² Specifically, it notes that “with respect to collateral, a secured party may not disable or render unusable any computer program or other similar device embedded in the collateral if immediate injury to any person or property is a reasonably foreseeable consequence of such action.”¹¹³ A secured party who violates this provision “shall be liable in accordance with applicable rules of law to any person who sustains an injury to person or property as a *reasonably foreseeable* result of the secured party’s action.”¹¹⁴ Although there has been no case in Colorado that interprets what exactly qualifies as a “reasonably foreseeable” injury, it appears that in Colorado, lenders and auto dealers who have full faith in the safety of SIDs can use them legally under Colorado law.

Connecticut’s statute is also based on UCC section 9-609 and references the use of electronic devices to disable collateral,¹¹⁵ but it places more restrictions on the use of SIDs and similar devices than Colorado does. In Connecticut, “[e]lectronic self-help is permitted only if the debtor separately agrees to a term of the security agreement authorizing electronic self-help.”¹¹⁶ It also notes that

[b]efore resorting to electronic self-help . . . the secured party shall give notice to the debtor stating: (A) [t]hat the secured party intends to resort to electronic self-help as a remedy on or after [15] days following communication of the notice to the debtor; (B) [t]he nature of the claimed breach which entitled the secured party to resort to self-help; and (C) [t]he name, title, address and telephone

111. Reg Wydeven, *Repossessing Cars in Wisconsin Can Be a Challenge*, POST-CRESCENT (Oct. 6, 2014, 5:00 AM), <http://www.postcrescent.com/story/money/2014/10/06/reposessing-cars-wisconsin-can-challenge/16656943>.

112. COLO. REV. STAT. § 4-9-609(e) (2001).

113. *Id.*; see also HUDSON COOK, LLP, *supra* note 14, at C-5 n.13 (stating the requirements under Colorado law when a creditor uses an electronic device to cause a collateral unusable).

114. COLO. REV. STAT. § 4-9-609(e) (emphasis added).

115. CONN. GEN. STAT. § 42a-9-609(d) (2013).

116. *Id.* § 42a-9-609(d)(2).

number of a person representing the secured party with whom the debtor may communicate concerning the security interest.¹¹⁷

It further notes that “electronic self-help may not be used if the secured party has reason to know that its use will result in substantial injury or harm to the public health or safety.”¹¹⁸ Therefore, the use of SIDs is legal provided that parties voluntarily and contractually “agree to the use of a device[] and comply with the other limitations imposed upon [SIDs] under Connecticut law, such use should comply with the UCC’s repossession provisions.”¹¹⁹

Outside its standard UCC section 9-609 statute, California, in the fall of 2012, enacted legislation that authorized the use of SIDs specifically for BHPH dealers.¹²⁰ Its statute is similar to that of Connecticut’s in that it requires the creditor to make certain disclosures to the buyer and to obtain the buyer’s consent prior to installing the SID.¹²¹ In California, either of the following can be true for the use of an SID to be valid: (1) the creditor uses the SID “solely to verify and maintain the operational status of the tracking technology, to repossess the vehicle, or to locate the vehicle to service the loan or keep the loan current”;¹²² or (2) the creditor uses the SID “solely for any optional service to the buyer,” the agreement to use the SID is kept separate from and not used as a condition for the purchase and sale agreement, and the buyer is informed of his or her ability to cancel the optional service any time in the future without affecting the purchase and sale of the vehicle.¹²³

The non-UCC law in Michigan appears to be that as long as the SID does not violate state law and the lender obtains prior consent from the consumer, SIDs are legal. In 2007, Michigan Chief Deputy Attorney General, Carol Isaacs, issued an “informational letter” indicating that “[an SID] may not be used in a manner that would violate state law, such as discriminating against a protected class of individuals.”¹²⁴ Michigan subsequently passed a law in 2010 criminalizing a person who installs a tracking device in a consumer’s car “without the knowledge and consent of the owner of that [car].”¹²⁵ Therefore, in Michigan, it appears that SIDs are legal unless the SID violates generally applicable state laws or the lender fails to obtain prior consent from the consumer.

117. *Id.* § 42a-9-609(d)(3).

118. *Id.* § 42a-9-609(d)(5).

119. HUDSON COOK, LLP, *supra* note 14, at C-5.

120. CAL. CIV. CODE § 2983.37(2) (West 2012 & Supp. 2015); *see also* HUDSON COOK, LLP, *supra* note 14, at C-6. For more information on what a BHPH dealer is, *see supra* Part II.A.2.

121. CAL. CIV. CODE § 2983.37(a)(1)–(2).

122. *Id.* § 2983.37(a)(1)(A).

123. *Id.* § 2983.37(a)(1)(B).

124. HUDSON COOK, LLP, *supra* note 14, at C-7.

125. MICH. COMP. LAWS § 750.539*l* (Supp. 2015); HUDSON COOK, LLP, *supra* note 14, at C-8.

iii. *Category Three: States That Proposed but Did Not Pass Laws Regarding SIDs*

The third category represents states that have proposed but failed to pass a bill approving or prohibiting SIDs. One state, Nevada, failed to pass legislation approving of the use of SIDs. New York, on the other hand, failed to pass legislation disapproving of the use of SIDs.

Nevada proposed but failed to pass detailed legislation similar to California's that would have allowed the use of SIDs or similar devices only under certain restrictive conditions. The 2013 Nevada Assembly Bill No. 187 would have barred a creditor from using an SID unless the creditor entered an agreement with the debtor for use of that SID that was separate from the installment contract to purchase or lease the car.¹²⁶ It further required that the creditor use an SID "only to ensure that the electronic tracking technology is operating properly, to repossess the [car], to locate the [car] for the purpose of servicing the lease installment contract or to keep the lease installment contract current."¹²⁷ Additionally, the debtor would have been able to cancel the creditor's use of the SID any time after the sale without affecting the sale or any terms of the sale agreement.¹²⁸ The Nevada Assembly approved this proposed bill on April 23, 2013, but the bill failed to pass the Nevada Senate, leaving the legality of SIDs in Nevada unaddressed.¹²⁹

In October 2014, the New York Senate introduced Senate Bill No. 7944 that prohibited the installation of SIDs in certain new or used cars.¹³⁰ The proposed bill provided that "[n]o new or used [car] dealer or lender shall be permitted to install [an SID] on a [car] purchaser's or lessee's [car]," and a violation would be "punishable by a fine not to exceed five thousand dollars."¹³¹ The bill ultimately failed to pass the New York Senate Rules Committee.¹³²

iv. *Assessing the State of the Law*

In summary, it appears generally that SIDs may be legal in most states due to the secured party's right to the "self-help" repossession provisions of UCC section 9-609. Some states like California, Colorado, and Connecticut have specific laws that allow the use of SIDs under specific conditions, with debtor's right to cure, debtor knowledge, and debtor consent being requirements consistent across these states. Other states like Iowa and Kansas

126. Assemb. B. 187, 77th Leg., Reg. Sess. (Nev. 2013).

127. *Id.*

128. *Id.*

129. *Nevada Assembly Bill 187 (Prior Session Legislation)*, LEGISCAN, <http://legiscan.com/NV/bill/AB187/2013> (last visited Jan. 13, 2016) ("Status: Engrossed on April 24, 2013—50% progression, died in chamber.").

130. S.B. 7944, 237th Gen. Assemb., Reg. Sess. (N.Y. 2014).

131. *Id.* §§ 2-3.

132. *New York Senate Bill 7944 (Prior Session Legislation)*, LEGISCAN, <https://legiscan.com/NY/bill/So7944/2013> (last visited Jan. 13, 2016).

issued informal opinions, again indicating approval of SIDs so long as lenders comply with the debtor's right to cure and do not violate any other state laws. In contrast, although Wisconsin does not have a codified statute and New York failed to pass a bill objecting to SIDs, it is evident both states disfavor their use.

Against this backdrop, it remains unclear in more than half of the states whether an SID is legal. Even the states that have regulated SIDs in part do not definitively answer the question. As Parts II.A.3 and III.B make clear, however, lenders and dealers continue to use SIDs as leverage during the sale-purchase process and are not impeded by the current unsteadiness in the law. This is particularly apparent in the subprime auto loan market where dealers grant credit to subprime borrowers.

III. SIDS FUELING A POTENTIAL SUBPRIME AUTO "BUBBLE"

This Part explores the average subprime borrower's financial characteristics and depicts how current subprime auto lending practices (i.e., using SIDs in disguise of what is actually predatory lending¹³³) directed at these borrowers are improperly aligned with the typical subprime borrower's ability to pay. It also provides evidence of the effects of the subprime auto lending industry on the larger economy, issues arising from SID-infected subprime auto loans, and problems associated with a lack of steady regulation.

A. THE VULNERABILITY OF THE SUBPRIME AUTO BORROWER

The subprime borrower has unique characteristics distinct from the prime borrower.¹³⁴ For example, a subprime borrower is typically an individual with low income and a FICO score below 660.¹³⁵ The National Bureau of Economic Research sponsored a survey of subprime auto lending in 2007 that gives a vivid picture of the typical subprime borrower.¹³⁶ The survey looked at over 50,000 credit applications between June 2001 and December 2004 for a large auto sales company that primarily served subprime borrowers.¹³⁷ Among various financial characteristics, the survey reported that the monthly household income for the median applicant was \$2411; that a majority of the applicants rented a home or lived with their parents; that a

133. "Predatory lending is any lending practice that imposes unfair or abusive loan terms on a borrower. It is also any practice that convinces a borrower to accept unfair terms through deceptive, coercive, exploitative or unscrupulous actions for a loan that a borrower doesn't need, doesn't want or can't afford." Bill Fay, *What Is Predatory Lending?*, DEBT.ORG, <http://www.debt.org/credit/predatory-lending> (last visited Jan. 13, 2016).

134. A prime borrower is an individual with a good credit history (i.e., credit worthy) and usually has a FICO score above 620. LaToya Irby, *What Is a Prime Borrower*, ABOUT: MONEY, <http://credit.about.com/od/or/g/prime.htm> (last visited Jan. 13, 2016).

135. See *Glossary: Subprime Borrower*, *supra* note 4 (describing who a subprime borrower is); see also Detweiler, *supra* note 4 (describing both definition and use of FICO scores).

136. See generally William Adams et al., *Liquidity Constraints and Imperfect Information in Subprime Lending*, 99 AM. ECON. REV. 49 (2009).

137. See *id.* at 52-53.

third did not have a savings or checking account; and that “more than half . . . had a delinquent balance within six months prior to their loan application.”¹³⁸ These borrowers usually take on large loan amounts with corresponding small down payments and high finance charges.¹³⁹

Additionally, the survey lays out two financial liquidity constraints that subprime borrowers face. The first constraint measures the borrower’s purchasing sensitivity in relation to the borrower’s “current and predictable future cash flow.”¹⁴⁰ The survey indicates that subprime borrowers in particular are likely to increase their purchases or take on more credit in response to a “predictable temporary spike in cash flow, such as a tax rebate.”¹⁴¹ In other words, a subprime borrower is likely to make a purchase unsupported by a steady flow of future income. The second, which the survey notes is “the mirror image of the first,” is that the subprime borrower places a higher value on the opportunity to defer payments than in determining the present value of future payments and failing to use the latter in purchasing decisions.¹⁴² In other words, for the subprime borrower, lower payments today carry more weight even if that means larger payments in the future.

A majority of subprime auto borrowers with these purchasing characteristics default on their loans.¹⁴³ Thus, payment default—in particular, defaults on a large scale—is the ultimate evil to avoid. The evil is not in subprime auto lending; rather, it is in irresponsible credit finance practices, such as the use of SIDs in the credit decision process, that lead to payment default or, at the very least, exacerbate defaults. Because subprime auto lenders are using SIDs to fuel the rise in the subprime auto industry, SIDs play a significant, yet improper, role in the credit decision process that is totally unconnected with the subprime borrower’s ability to make the car payments as they come due.

B. A PICTURE OF HOW SIDS ARE FUELING A SUBPRIME AUTO INDUSTRY BUBBLE

Even as the current economy continues to struggle to bounce back from the mortgage crisis, subprime auto lending booms at an increasingly faster rate, compared to prime auto lending.¹⁴⁴ There is no question that a major

138. *Id.* at 53.

139. *See id.* at 54 (noting that “[o]ver 85 percent of the loans [in the survey] [had] an annual interest rate over 20 percent,” and giving an example that a borrower who took an \$11,000 loan financing it over 42 months at an interest rate of 30% would make interest payments totaling \$6000).

140. *Id.* at 56.

141. *Id.*; *see also* Ken Bensinger, *A Vicious Cycle in the Used-Car Business*, L.A. TIMES (Oct. 30, 2011), <http://articles.latimes.com/2011/oct/30/business/la-fi-buy-here-pay-here-part1-storyb> (“Dealers report a surge in sales in the three months leading up to tax day.”).

142. Adams et al., *supra* note 136, at 156.

143. *See id.* at 54 (noting that most of the loans in the survey of over 50,000 loans ended in default).

144. *See* MARTIN & RISI, *supra* note 42, at 2 (noting that “subprime lending activity is already close to pre-financial crisis levels”); *see also* *Bad Karma: Borrowers, Not Lenders, Have More to Fear from the Latest Subprime Lending Boom*, ECONOMIST (Sept. 27, 2014), <http://www.economist.com/>

explanation for the increase in subprime auto lending is technology—specifically auto lenders installing SIDs in borrowers' cars as a condition for granting the borrower credit and, in effect, using SIDs as part of their credit underwriting process.¹⁴⁵ Specifically, auto lenders have loosened their credit and underwriting procedures and are granting credit to more subprime borrowers because the lenders feel safer and more confident that the borrower will make the payments for fear that their car would be unusable.¹⁴⁶

Thus, in most instances, even though the consumer technically has a choice of whether or not to consent to an installation of an SID in the car, in reality, the consumer does not have any choice at all. Subprime auto lenders

news/finance-and-economics/21620288-borrowers-not-lenders-have-more-fear-latest-subprime-lending-boom-bad (noting that though new loans have increased 64% since 2009, subprime auto lending “ha[s] grown even faster, by 93% since 2009”). It is even more evident that subprime auto lenders are making more auto loans to “deep subprime” borrowers—borrowers with very low FICO scores (typically below 550)—than to regular subprime borrowers. Peter Eavis, *Stressed Borrowers Rattle Resurgent Subprime Lending Industry*, N.Y. TIMES: DEALBOOK (Sept. 11, 2014, 8:48 PM), <http://dealbook.nytimes.com/2014/09/11/stressed-borrowers-rattle-resurgent-subprime-lending-industry> (“Deep-subprime loans increased 13 percent in the second quarter, or about 770,000 loans, compared with the same period a year earlier. That jump far outpaced the 5 percent increase for regular subprime loans.”).

145. See Corkery & Silver-Greenberg, *supra* note 1 (noting that SIDs “are helping feed the subprime boom” and that “without them . . . millions of Americans might not qualify for a car loan at all”). A general manager of a subprime auto lender stated that, without using SIDs, his company “would be unable to extend loans because of the high-risk nature of the loans.” *Id.*; see also Letter from Steve Jordan, Chief Operating Officer, Nat’l Indep. Auto. Dealers Ass’n, to Mike Feuer, Chair of Assembly Judiciary Comm., at 2 (Apr. 17, 2012), http://www.niada.com/uploads/dynamic_areas/iUThjum5ZeLiYChq8NZh/38/NIADA%20Opposition%20Letter%20-%20CA%20AB%201447.pdf (noting that SIDs “allow[] BHPH dealers to grant consumer credit with more flexible contract terms, lower down-payment requirements and access to higher valued [cars] because the dealers have a greater assurance that their collateral can be located in the event of [consumer] default”). As mentioned, auto lenders condition credit on the installation of the SID and require the borrower to consent to the installation. An example of language contained within a contract between an auto lender and a borrower notes the following:

We require the installation of the Device in the [car] as a condition to our extension of credit to you under the Contract. You are not obligated to purchase a [car] from us. You are free to obtain a [car] or [car] financing from another source that does not require installation of the Device or a similar starter interrupt system. By executing this Agreement and Disclosure and the Contract, you acknowledge that you have voluntarily chosen to purchase and finance the [car] and consent to having the Device installed in the [car].

Customer Disclosure Form, A.R.A. GPS SYS., <http://www.aragps.com/customer-disclosure-form> (last visited Jan. 13, 2016).

146. See Teddy Nykiel, *Subprime Auto Loans: Boon or Bane?*, NERDWALLET (Aug. 12, 2014), <http://www.nerdwallet.com/blog/current-events/subprime-auto-loans-boon-or-bane-3> (noting that “[t]he standards for subprime auto loans have gotten so relaxed that banks and other lenders have been giving them out left and right”); see also Robert Szytko, *Your Car Won’t Start. Did You Make the Loan Payment?*, NAT’L PUB. RADIO (Oct. 16, 2014, 2:21 PM), <http://www.npr.org/blogs/sections/alltechconsidered/2014/10/16/356693782/your-car-wont-start-did-you-make-the-loan-payment> (noting that “[t]he [SID] has helped feed into the growing subprime auto loan market, as it allows lenders to extend subprime loans with greater confidence”).

are in effect using SIDs as a springboard to exploit subprime borrowers in an industry that is already known for such exploitative behavior.¹⁴⁷ A 2011 *Los Angeles Times* article gives a vivid picture of the “bare-knuckle” auto credit processes of subprime lenders, specifically BHPH dealers.¹⁴⁸ The article notes that BHPH dealers “turn clunkers into cash cows and make money off the least creditworthy [consumers],” a group covering “millions of Americans who are stuck in low-paying jobs, saddled with debt and unable to qualify for conventional auto loans.”¹⁴⁹ The BHPH dealers’ deceitful approach to car sales is relatively straightforward—sell cars (usually clunkers) to subprime borrowers, charge them high interest rates, repossess the car after the borrower defaults, place the repossessed car back on the lot, then sell the car again to another subprime borrower (sometimes for even more than the original sale price), and start the cycle afresh.¹⁵⁰

To the extent a subprime auto lender, or a BHPH dealer in this case, can sustain this cycle, the lender almost always makes a profit irrespective of whether the borrowers are able to keep up with their payments.¹⁵¹ The result of this practice is that subprime borrowers typically end up with loans higher than the value of the car (a fact reminiscent of the mortgage crisis), ultimately resulting in loan defaults and sometimes bankruptcy.¹⁵²

A *Los Angeles Times* article gives an example of “a single mother with three children” making only \$27,000 a year, who had bad credit and could not find a conventional car loan.¹⁵³ The mother said “she had no choice” regarding the offer the BHPH dealer gave her: a \$3000 down payment and a \$387 payment each month for four years at an interest rate of 20.7%.¹⁵⁴ She defaulted on the loan a year and a half later and the lender repossessed the car.¹⁵⁵ For consumers like this single mother, it is evident that their ability to fulfill the monthly scheduled payments is unrelated to whether or not an SID is installed in the consumer’s car. The use of SIDs in such instances evidences

147. See Bensinger, *supra* note 141 (describing the exploitative practices of subprime auto lenders, particularly BHPH dealers).

148. *Id.*

149. *Id.*

150. See *id.* (noting that buyer default is actually profitable to the subprime auto dealer because the “[t]he car can be repossessed and put back on the lot for sale in short order. . . . A new buyer makes a down payment, takes on a high-interest loan and the cycle starts anew”).

151. *Id.*

152. See Jessica Silver-Greenberg & Michael Corkery, *In a Subprime Bubble for Used Cars, Borrowers Pay Sky-High Rates*, N.Y. TIMES: DEALBOOK (July 19, 2014, 12:36 PM), http://dealbook.nytimes.com/2014/07/19/in-a-subprime-bubble-for-used-cars-unfit-borrowers-pay-sky-high-rates/?_php=true&_type=blogs (noting that in many instances subprime “borrowers end[] up shouldering loans that far exceeded the resale value of the car” and that “can thrust already vulnerable borrowers further into debt, even propelling some into bankruptcy”).

153. Bensinger, *supra* note 141.

154. *Id.*

155. *Id.*

the fact that SIDs have no logical connection to a subprime borrower's ability to pay.

In other words, because these lenders have consumers who have "no choice," the sky is the limit in regards to additional big-brother-type devices that subprime auto lenders can tack onto the cars that subprime borrowers purchase. Additionally, some subprime auto lenders in the market exacerbate the problem by committing blatant fraud and fabrication of the credit lending process.¹⁵⁶

Putting aside the unfortunate truth that the consumer is the one who loses in the end (in terms of building a bad credit history, having no car due to repossession, negative social effects, and the like), and focusing instead on the economic side of things, subprime auto lending is a profitable business. After all, if the first borrower defaults, the lender can repossess the car and resell it at a higher interest rate to another borrower. The story, however, is not that simple. Lenders package these subprime auto loans into ABS and sell them to investors—a practice that has its own economic risks.¹⁵⁷ Part III.C below discusses some of these economic risks.

C. SUBPRIME AUTO LOAN INVESTMENTS AND THE ECONOMY

In response to the mortgage crisis, the Federal Reserve reduced both short- and long-term interest rates to strengthen business and consumer spending and help revive the economy back to pre-crisis levels.¹⁵⁸ With low interest rates, however, investors hungry for high returns have turned to securities backed by subprime auto loans that offer high rates of return.¹⁵⁹ These investors include "some of the nation's biggest banks and private equity firms" who subsequently bundle the subprime loans "into complex bonds and

156. See Silver-Greenberg & Corkery, *supra* note 152 (noting that some subprime auto lenders "fabricate or ignore borrowers' abilities to repay" and stating that in its own investigations, it "found dozens of loans that included incorrect information about borrowers' income and employment, leading people who had lost their jobs, were in bankruptcy or were living on Social Security to qualify for loans that they could never afford"). *The New York Times* also reported on a Texas lender that paid \$2.75 million in penalty for giving credit-reporting agencies fictitious information related to "thousands of car buyers." Jessica Silver-Greenberg & Michael Corkery, *Texas Car Lender Is Accused of Distortion in Subprime Inquiry*, N.Y. TIMES: DEALBOOK (Aug. 20, 2014, 8:46 PM), <http://dealbook.nytimes.com/2014/08/20/first-investors-financial-services-pays-penalty-in-credit-report-case>.

157. See Christopher K. Seide, *Consumer Financial Protection Post Dodd-Frank: Solutions to Protect Consumers Against Wrongful Foreclosure Practices and Predatory Subprime Auto Lending*, 3 U.P.R. BUS. L.J. 219, 249 (2012) (noting that "[BHPH] dealerships are issuing car loans to consumers who have bad credit and then packaging the loans and selling them to investors in secondary financial markets").

158. Laura Wagner, *Fed Leaves Record-Low Interest Rates Unchanged*, NAT'L PUB. RADIO (Oct. 28, 2015), <http://www.npr.org/sections/thetwo-way/2015/10/28/452568629/fed-leaves-record-low-interest-rates-unchanged>.

159. See Sarah Mullholland, *Subprime Trading Like It's 2007 in Car-Loan Backed Bonds*, BLOOMBERG BUS. (June 13, 2014, 1:41 PM), <http://www.bloomberg.com/news/articles/2014-06-13/subprime-trading-like-it-s-07-in-car-loan-bonds-credit-markets> (noting that "[i]nvestors are turning to riskier debt to boost returns" as banks lower interest rates).

[sell] as securities . . . to insurance companies, mutual funds and public pension funds—a process that creates ever-greater demand for loans.”¹⁶⁰ There is some evidence that the boost in subprime auto lending, coupled with the bundling of subprime auto loans into securities and selling those securities to investors in the secondary market, mirrors the risky lending practices in the housing market that brought about the mortgage crisis a few years ago.¹⁶¹ If state and federal regulatory bodies fail to take corrective steps, there is a realistic possibility that this practice may negatively impact the economy.¹⁶² Indeed, credit rating agencies and other experts in the banking industry have raised concerns that auto lenders and investors are taking on too much risk through this subprime auto lending practice.¹⁶³

Inevitably, ABS investors hold securities that are backed by the payment stream of subprime auto loans. Because subprime auto lenders do not properly match the borrower’s payment ability to the borrower’s payment stream, there is a high risk in the long term that investors will experience massive losses at some point during the period of the loan. Adding to this problem, subprime auto lenders stretch these loans over a longer loan payment period,¹⁶⁴ and because the value of cars depreciates faster than, say, the value of buildings, the longer loan periods, combined with the high likelihood of default, increases the investors’ potential losses.

Even as federal regulators evaluate subprime ABS activity, investors continue to demand these subprime ABSs, and there is no apparent decrease of demand in sight.¹⁶⁵ “[C]ompanies sold \$14.2 billion of the securities through Aug[ust] 19, [2014,] compared with \$21.5 billion issued in all of 2013.”¹⁶⁶ Considering this trend, as long as interest rates stay low and investors

160. Silver-Greenberg & Corkery, *supra* note 152.

161. See, e.g., Seide, *supra* note 157, at 249 (“The prevalence and increase in subprime auto loans made to consumers who cannot afford monthly car payments mirror the same types of predatory lending practices associated with the subprime mortgage lending crisis in 2007–2008.”); Silver-Greenberg & Corkery, *supra* note 152 (“The surge in [subprime auto] lending and the lack of caution resemble the frenzied subprime mortgage market before its implosion set off the 2008 financial crisis.”); see also *Bad Karma*, *supra* note 144 (“There is much talk of a new subprime bubble, akin to the cavalier mortgage lending that helped spark the financial crisis.”).

162. See Silver-Greenberg & Corkery, *supra* note 152 (“Yet some banking analysts and even credit ratings agencies that have blessed subprime auto securities have sounded warnings about potential risks to investors and to the financial system if borrowers fall behind on their bills.”).

163. See *id.* (noting that the rating agency, Standard & Poor’s, cautioned investors of potential losses associated with these loans, and that “a high-ranking official at the Office of the Comptroller of the Currency” expressed concerns that lenders, specifically banks, are taking on too much risk with these loans).

164. This results in lower payments and induces subprime borrowers to borrow more than they can afford. Eavis, *supra* note 144.

165. See Sarah Mulholland, *Subprime Auto Loan Probe Fails to Curb Surging Bond Sales*, BLOOMBERG BUS. (Sept. 10, 2014, 11:54 AM), <http://www.bloomberg.com/news/articles/2014-09-10/subprime-auto-loan-probe-fails-to-curb-surging-bond-sales>.

166. *Id.*

seek higher returns on their investments, investors will continue to invest in high-return ABS securities. The problem, of course, in the long term is that delinquencies are likely to occur because subprime borrowers, the backbone of subprime ABSs, cannot keep up with the car payments.¹⁶⁷

In summary, subprime auto lenders use SIDs as a catalyst to boost their lending activities, particularly to subprime borrowers. This particular practice in and of itself is not necessarily wrong; however, when the subprime auto lender combines its all-too-familiar manipulative lending practices¹⁶⁸ with securitization of subprime auto loans sold to outside investors, the unmitigated risk of loan default expands from the auto lending industry to other sectors of the economy. Even though SIDs prove to be effective in the short term,¹⁶⁹ “history shows that a splurge on subprime lending nearly always leads to a crippling cascade of problems.”¹⁷⁰

D. EVIDENCE THAT SUBPRIME AUTO LENDING PROBLEMS ARE “HEATING UP”

Although the use of SIDs is not the sole problem plaguing subprime auto lenders’ risky credit lending practices, it continues to play a significant role in enticing subprime auto lenders to grant credit to subprime borrowers without fully considering or while totally ignoring the borrower’s ability to pay.¹⁷¹ Recent headlines suggest that subprime lenders’ failure to account for borrowers’ creditworthiness is presenting problems. Several media reports indicate increased delinquencies in subprime auto lending, causing consumer protection agencies to take a closer look at subprime auto lending practices.

The *New York Times* reported in September 2014 that although there is no cause for alarm regarding an imminent burst of the subprime auto bubble (similar to the mortgage crisis bubble), there are signs indicating that adverse effects have begun to erupt.¹⁷² It noted, for instance, that Experian (a credit

167. *See id.* (noting that as these subprime ABS investments increase, delinquencies on auto loans for subprime borrowers is on the rise).

168. This happens, for example, when auto lenders require SIDs as a condition of granting credit when the borrower might otherwise not be able to pay. *See supra* Part III.B (describing the exploitative behavior of subprime auto lenders and noting that these lenders use SIDs as a springboard to engage in such behavior).

169. *See, e.g.,* Corkery & Silver-Greenberg, *supra* note 1 (“[SIDs] are proving effective in coaxing payments from even the most troubled borrowers.”); Salinas, *supra* note 12 (“Thousands of dealers are now using [SIDs], and according to company executives, their firms have maintained double-digit growth for several years.”).

170. Eavis, *supra* note 144.

171. *See supra* Parts III.B–C (describing how subprime auto lenders leverage SID technology in exploiting subprime borrowers and eventually packaging these risky loans to investors).

172. Eavis, *supra* note 144 (noting that “some signs have appeared that suggest subprime lenders are pushing this [practice of increased lending to subprime borrowers] to the limit” and that “[t]he latest indicators are a reminder of the constraint that has always dogged subprime lending: The number of stressed borrowers who can take on debt and repay it with relative ease is often smaller than lenders believe”).

reporting agency) reported a significant increase in auto repossessions in the second quarter of 2014.¹⁷³

Furthermore, in 2014, subprime auto ABSs “that are more than 30 days late rose 1.43 percentage points to 7.59 percent in the 12 months end[ing] September 30, according to Standards and Poor’s. [That was] the highest [it had been] in at least three years.”¹⁷⁴ In fact, analysts expect investors holding bonds backed by subprime auto loans to experience increased losses in the near future due to expected corresponding increases in delinquencies surrounding subprime auto loans.¹⁷⁵ Therefore, irrespective of the potential degree of impact a subprime auto bubble burst will have on the economy, there are early warning signs that something bad could occur—warning signs that have caught the attention of federal regulators.¹⁷⁶ That the CFPB passed final rules placing nonbank auto lenders under the CFPB’s federal

173. *Id.* (“Repossessions carried out by finance companies, nonbank firms that focus mainly on subprime borrowers, rose to 2.75 percent of loans in the second quarter [of 2014], [up] from 1.13 percent in the same period a year earlier.”); see also Phil LeBeau, *More Car Buyers Struggling to Make Payments*, CNBC (Aug. 20, 2014, 8:45 AM), <http://www.cnbc.com/2014/08/20/more-car-buyers-struggling-to-make-payments.html> (noting that although the “[t]he number of delinquencies and repossessions rising is what we would expect as the auto industry sells more [cars], . . . this slight uptick is one to keep an eye on” (quoting Melinda Zabritski, senior director of automotive finance for Experian Automotive)).

174. Pater Tenebrarum, *Low Grade Credit Bubble Fraying at the Edges*, ACTING MAN (June 12, 2014), <http://www.acting-man.com/?p=31099> (emphasis omitted) (quoting Sarah Mulholland, *Subprime Auto Boom Besieged by Late-Payment Jump: Credit Markets*, BLOOMBERG BUS. (Mar. 5, 2014), <http://www.bloomberg.com/news/articles/2014-03-05/subprime-auto-boom-besieged-by-late-payment-jump-credit-markets>).

175. See *id.* (indicating that with an increase in subprime auto loan delinquencies, “bondholders will take from defaults on the debt, which stood at 6.92 percent at the end of September [2014] after falling to as low as 4.15 percent in 2011, [Standard & Poor’s] data show” (emphasis omitted) (quoting Mulholland, *supra* note 174)).

176. See, e.g., Jim Henry, *Dealers to Face More Lender Scrutiny*, AUTOMOTIVE NEWS (Oct. 8, 2014, 2:05 PM), http://www.autonews.com/article/20141008/FINANCE_AND_INSURANCE/310089998/dealers-to-face-more-lender-scrutiny (noting that CFPB has proposed a “larger participants” rule that will place nonbank auto lenders within the jurisdiction of the CFPB to allow the agency to “crack down on unfair, deceptive or abusive acts or practices”); Peter Rudegeair, *Exclusive: U.S. Regulators Press Banks for More on Auto Loan Exposure to Assess Risks*, REUTERS (Oct. 12, 2014, 2:58 PM), <http://www.reuters.com/article/2014/10/12/us-autos-lending-regulators-idUSKCN0I10T320141012> (noting that federal regulators are asking auto lenders for more details regarding their auto lending practices for “fear that reckless lending may be at least helping to fuel [the auto lending growth—prime and subprime], and there are early signs that delinquencies are increasing in the sector”); Alan Zibel & Christina Rogers, *U.S. Consumer-Finance Regulator Plans Auto-Lending Examinations*, WALL STREET J. (Sept. 16, 2014, 3:18 PM), <http://online.wsj.com/articles/u-s-consumer-finance-regulator-plans-auto-lending-examinations-1410885756> (noting CFPB’s plan to review credit lending practices of several auto lenders “amid growing concern [that] consumers are being steered into loans they can’t afford and sold pricey add-on products whose total costs may not be clearly disclosed”). See generally Cordray, *supra* note 26 (proposing that CFPB asserts authority over nonbank auto lenders to “level the playing field for banks and nonbanks in the auto lending market” and ensure lenders treat consumers “honestly and fairly”).

supervision is a testimony of the increased concern surrounding subprime auto lending practices.¹⁷⁷

E. *LACK OF STEADY SID REGULATION IS HURTING CONSUMERS*

The current unsteady nature of state laws surrounding the legality of SIDs¹⁷⁸ creates a negative socio-economic impact on the subprime consumer and presents public safety concerns. This negative impact stems from the fact that the laws regulating SIDs currently fail to ensure that SIDs function appropriately and that lenders properly manage the operation of the device on their borrowers' cars. Many practices that are legal in some states are not legal in states like Connecticut that require the lender to give notice to the borrower 15 days prior to disabling the car.¹⁷⁹

Connecticut-type restrictions do not protect borrowers in many other states. For example, in March 2014, a single mother living in Las Vegas could not take her ten-year-old asthmatic daughter, who had a 103.5-degree fever, to the emergency room because a subprime auto lender remotely deactivated her car after she fell only "three days behind on her monthly car payment."¹⁸⁰ To reactivate her car, she would have "had to pay more than \$389, money she did not have that morning in March."¹⁸¹ Some auto lenders have disabled borrowers' cars when the borrowers were only a few days behind in their payments, leaving the borrowers "stranded in dangerous neighborhoods."¹⁸² Other borrowers say that lenders disabled their cars "while idling at stoplights."¹⁸³ Some borrowers say that they were unable to take their children to school or to see the doctor, and a Nevada woman's car was shut down while she drove on the highway.¹⁸⁴

When financially healthy, subprime borrowers contribute to a well functioning national economy. Rather than help subprime borrowers enhance their credit history and get back on their feet economically, SIDs allow lenders to make riskier loans with more draconian terms that tend to drag subprime borrowers further into debt. A borrower's ability to drive to and from work or to take their kids to school, to see a doctor, or to soccer practice, has an indirect impact on the subprime borrower's socio-economic status. Without direct state regulations like those in Connecticut and California, the negative impact on subprime borrowers is bound to continue.

177. See *supra* notes 82–85 and accompanying text.

178. See *supra* Part II.C.2 (describing the current status of state laws pertaining to SIDs).

179. See *supra* text accompanying notes 115–18 (describing the electronic self-help laws in Connecticut).

180. Corkery & Silver-Greenberg, *supra* note 1.

181. *Id.*

182. *Id.*

183. *Id.*

184. *Id.*

IV. CFPB SHOULD PROVIDE TARGETED SID SUPERVISION OF SUBPRIME AUTO LENDERS AND STATES SHOULD PASS APPROPRIATE AND TARGETED REGULATIONS ON SIDS

Human beings should leverage every technological advancement in a positive manner to maximize its contributions rather than use the technology to achieve ends contrary to its purpose. Using an SID as an indicator of a borrower's ability to repay increases the risk of default, which could have catastrophic effects not only on the borrower but also on the national economy. Subprime auto lenders should limit use of SIDs to their operational purpose—locating a car and helping with its repossession when a borrower defaults—rather than also using it during the credit origination and underwriting stage as a condition to grant a loan.

This Part makes three recommendations about how to prevent future negative economic effects from affecting subprime borrowers and the national economy. First, subprime auto lenders should limit usage of the SID to its operational purpose—locating a car and helping with its repossession when a borrower default. Second, federal regulators should play an oversight role ensuring that subprime auto lenders use SIDs for their limited intended purpose. Specifically, the CFPB's examination procedures should be enhanced to include a targeted review of SIDs from a risk management perspective. Third, states should retain the power to enact laws that regulate SIDs and ensure subprime auto lenders use them effectively in managing the risk of borrower delinquencies.

A. *SUBPRIME AUTO LENDERS SHOULD KEEP THE SID OUT OF THEIR CREDIT DECISION MAKING PROCESS*

Subprime auto lenders should keep the decision about whether to use an SID separate from their decision about whether to grant a borrower credit. To blend the two is to place too much reliance on a factor that does not increase the likelihood that a borrower will make good his or her promise to repay the loan. As illustrated by the discussion of the mortgage crisis in Parts II.B and III.C, it is not sound credit risk management to tolerate lending practices that are not tied to a borrower's ability to repay, and when defaults occur on a mass scale, negative effects can ripple throughout other sectors of the economy. Subprime auto lenders should separate operational risk from credit risk and keep the decision about whether to use an SID out of the decision about whether to grant credit.

Keeping SIDs outside of the credit decision process is a good approach for three reasons. First, it helps balance the bargaining power between the consumer and the lender during the loan origination process. No longer can the lender force an SID on a borrower as a condition for credit. And although lenders may still insist on using SIDs to help with repossession of the car in case of default, refraining from using the SID as a condition of granting a loan will bring about opportunities for the lender and borrower to work out details

of using the SID that are mutually beneficial. Second, it will enable the lender to practice responsible loan underwriting by focusing on traditional indicators of a borrower's ability to pay such as the borrower's FICO score, payment history, current amount of debt, and length of credit history.¹⁸⁵ And third, responsible lending habits will ultimately help insulate subprime auto ABSs sold in secondary markets from a systemic risk of loan delinquency.

Subprime auto dealers and lenders, however, argue that SIDs should be part of the credit underwriting process because without them, millions of consumers would not qualify for a car loan.¹⁸⁶ Additionally, they argue that SIDs bring financial security because a consumer who drives a car with an SID is more likely to make the monthly car payments—for fear that lender will shut off the starter in the car—than a consumer who does not have a car installed with an SID.¹⁸⁷ Subprime auto lenders reiterated this argument in a survey conducted by the National Alliance of Buy Here, Pay Here Dealers (“NABD”)¹⁸⁸ in April 2012. NABD surveyed 164 respondents who were users of SIDs and noted that 78% of the “survey respondents indicated that the use of devices allows greater credit-granting flexibility.”¹⁸⁹ It further noted that this credit granting flexibility was “[p]erhaps the biggest . . . benefit of [SIDs]” in that auto lenders can now “alleviate their dependence on such other risk mitigation methods ([such as] higher interest rate or larger down payment).”¹⁹⁰

These arguments are, however, misplaced. It is one thing to claim that SIDs are needed to help auto dealers and lenders determine the location of the collateral (i.e., the car) and retrieve it efficiently.¹⁹¹ It is quite another to say that SIDs should therefore determine whether or not the auto lender should grant credit to a particular consumer. The benefits that SIDs provide are separate from the question of whether a lender should approve a consumer for a car loan. Lenders, and indeed consumers, can still reap these

185. See *infra* note 196 and accompanying text.

186. See *supra* notes 144–45 and accompanying text (indicating that auto lenders are using SIDs in their credit-underwriting process).

187. See *supra* notes 144–45 and accompanying text (indicating that auto lenders who use SIDs feel secure that the borrower will make due on the contractual loan payments).

188. NABD “is an association focusing exclusively on the needs of the BHPH industry and is dedicated to improving the quality of BHPH dealers through education, ongoing training, and by promoting the interests of self-finance dealers nationwide.” NAT’L ALLIANCE OF BUY HERE PAY HERE DEALERS, <http://www.bhphinfo.com> (last visited Jan. 13, 2016).

189. NAT’L ALLIANCE OF BUY HERE PAY HERE DEALERS, MAY 2012—PAYMENT DEVICES BEST PRACTICES—NABD STUDY #3, at 1–2 (2012), <http://www.svrtrackingservices.com/wp-content/uploads/2014/10/May-2012-Payment-Devices-Best-Practices.pdf>.

190. *Id.*

191. See *id.* at G-3 (“The cost of repossession, the cost of impound fees that may occur, and the subsequent costs to recondition the vehicle (after recovery) are reduced by locating the [car] with GPS technology.”).

benefits without the SIDs influencing the consumer's ability to obtain the loan in the first place.

The financial status and credit history of consumers should ultimately determine whether they are eligible for a loan. A consumer either has the financial capability to make monthly payments or does not. Even if SIDs are effective in the short term, the information garnered from the technology does not dictate whether subprime borrowers will fulfill other contractual payments (e.g., home mortgage, child support, insurance, etc.). Thus, in the long run, if subprime auto dealers and lenders do not separate SID technology from the credit underwriting process, it could prove disastrous for the subprime auto industry. Using SIDs as intended—to simply locate collateral—ensures that the benefits associated with the technology are not temporary and do not only favor the subprime auto dealers and lenders but benefits the overall loan process and the borrower as well.

B. THE CFPB SHOULD PERFORM A MORE TARGETED EXAMINATION OF SIDS FOR NONBANK "PARTICIPANTS" THAT FALL UNDER ITS SUPERVISION

As the main consumer finance protection agency of the federal government, the CFPB should take steps to change the status quo of subprime auto lending practices, specifically as it relates to how these lenders utilize SIDs in granting auto credit. As mentioned in Part II.C.1, the CFPB only recently in June 2015 passed final rules that extended its federal supervision to subprime auto lenders with 10,000 or more in aggregate annual loan originations.¹⁹² This is a step in the right direction to ensure strong credit risk management practices in the auto lending industry, to enforce consumer financial laws, and to financially protect millions of subprime consumers. Additionally, the new CFPB rules will mitigate the risk of a market burst particularly in the subprime auto lending industry.

According to the CFPB, the 10,000 threshold "is a reasonable and appropriate threshold for defining larger participants of the automobile financing market."¹⁹³ Concurrent with passing its final rules and as it specifically relates to oversight of SIDs, the CFPB published its examination procedures for evaluating auto lenders that fall under its supervision.¹⁹⁴ Although these new examination procedures specifically mention coverage of SIDs, the coverage appears to focus only on ensuring accurate disclosure and information provided to borrowers during the loan origination process.¹⁹⁵

192. See *supra* notes 82–85 and accompanying text.

193. CORDRAY, *supra* note 82, at 71.

194. CONSUMER FIN. PROT. BUREAU, EXAMINATION PROCEDURES: AUTO FINANCE (2015), http://files.consumerfinance.gov/f/201506_cfpb_automobile-finance-examination-procedures.pdf.

195. For example, the "Repossessions" section of the procedures provides the following as it relates to SIDs:

2. Assess the servicer's policies and procedures for using SIDs or other payment assurance devices, including if the payment assurance device was used in accordance

The CFPB deserves a lot of credit for including auto lenders under its federal supervisory umbrella and, more importantly, for attempting to address the use of SIDs in the auto lending industry.

The SID review procedures could, however, be enhanced to ensure that auto lenders separate operational risk from credit risk. The CFPB should implement procedural steps when conducting an “on-site examination”¹⁹⁶ by focusing on the lender’s installment credit contracts to ensure that the lender keeps the credit underwriting process *separate* from the decision about whether to install an SID. Ensuring that consumers obtain adequate and accurate information regarding SIDs is a step in the right direction. However, to ensure proper risk management lending practices, the CFPB should develop procedures that also examine the auto lenders credit risk process. In particular, the procedures must ensure that auto lenders cannot use devices and other conditional requirements with no connection to the borrower’s ability to pay when assessing the borrower’s credit risk. This ensures that subprime auto lenders use SIDs solely to manage operational risk as opposed to credit risk. Additionally, a targeted examination by the CFPB of subprime auto dealers’ and lenders’ credit underwriting processes ensures that traditional underwriting factors become the only factors that determine whether the auto lender will grant the borrower the loan as well as what the terms of that loan will be. Traditional underwriting factors include the borrower’s FICO score, payment history, current amount of debt compared to assets, length of credit history, and frequency of new debt applications.¹⁹⁷

with the *disclosure* provided regarding the device at origination and how payment assurance devices are removed from vehicles after the loan or lease has been paid off.

....

3. Assess the quality of the servicer’s *data and information* to determine if the use of the SID is appropriate.

....

4. Assess the *quality of the servicer’s communications* with borrowers with SIDs to determine if the use of the SID is clear.

Id. at 49 (emphasis added).

196. See RICHARD CORDRAY, CONSUMER FIN. PROT. BUREAU, DEFINING LARGER PARTICIPANTS OF THE AUTOMOBILE FINANCING MARKET AND DEFINING CERTAIN AUTOMOBILE LEASING ACTIVITY AS A FINANCIAL PRODUCT OR SERVICE 5–6 (2014), http://files.consumerfinance.gov/f/201409_cfpb_proposed-rule_lp-v_auto-financing.pdf (describing the CFPB’s typical examination process of institutions under its scope of federal authority).

197. See CORELOGIC, UNDERSTANDING CREDIT & CREDIT RISK SCORES 5–7 (2011), <https://www.credco.com/assets/pdfs/datasheets/FICO-booklet.pdf> (describing what typically goes into a consumer’s credit rating); see also NANCY PIERCE, NON-PRIME AUTO LOANS 9 (2011), http://filene.org/assets/files-brains/Non_Prime_Auto_Loans_Toolkit_Dec_2013.pdf (noting that “[t]he overall goal when making the loan is to structure it so that it succeeds,” and that “the underwriter must decide whether the borrower’s history suggests the person will pay it back”).

Furthermore, and as it pertains specifically to SIDs, the CFPB should serve a federal-oversight function—focusing on auto lender credit underwriting risk management programs during its on and offsite examinations—and leave direct regulation of SIDs to the states. As part of its oversight function, the CFPB should pass and enforce laws that ensure that subprime auto lenders keep separate the decision of whether to install SIDs or other “ancillary” add-on products from the installment credit agreement as opposed to, for example, passing laws approving or prohibiting the use of SIDs. This will result in a clear and efficient regulatory system leveraging the different state secured-transaction and consumer-protection laws. Moreover, providing an oversight function while leaving direct regulation of SIDs to the states promotes state sovereignty and preserves federalism.

C. STATES SHOULD PASS APPROPRIATE AND TARGETED REGULATION ON SIDS

States should retain their ability to regulate and decide the legality of SIDs. As noted in Part II.C.2, while the legality and use of SIDs currently varies across states, the general approach is trending towards approval in most states. Just because SIDs are legal under state law does not mean that states should not continue to consider and regulate their effects. States should assess their regulations to determine whether they are adequate to mitigate the risk of irresponsible lending practices, such as was the case during the mortgage crisis.

To ensure strong credit risk management of the subprime auto lending industry, states that allow SIDs or permit them under certain conditions should prevent subprime auto lenders from improperly leveraging SIDs as part of their credit underwriting process. States should craft their regulations to ensure subprime loans are ultimately commensurate with the borrower’s ability to pay. To accomplish this, state legislatures and related agencies should go beyond informal action and pass laws that clearly approve or disapprove the use of SIDs. If a state approves the use of SIDs, the state should require the auto lenders to keep the credit decision separate from the decision to use the SID.¹⁹⁸

In crafting their codes, states would do well to consider California’s code as a model. California’s Civil Code section 2983.37 is exemplary, albeit imperfect. It requires auto dealers—specifically BHPH dealers who use

198. As a side note, for states that approve the use of SIDs, insurance divisions of the state governments could consider approving use of SIDs by car insurance companies within their respective jurisdictions. For example, so long as SIDs are operable only when the car is stationary, the insurance company can disable the consumer’s car if the insurance policy expires due to the consumer failing to make the monthly premium payments. This would save responsible consumers as well as the insurance companies billions of dollars, costs incurred when uninsured motorists cause car accidents. See Leslie Scism, *Uninsured Driver Dilemma*, WALL STREET J. (Dec. 1, 2013), <http://www.wsj.com/articles/SB10001424052702303281504579221972801700610> (noting that uninsured and underinsured coverage costs responsible drivers and insurance companies \$11 billion to \$12 billion).

SIDs—to use SIDs only for the operational purpose of locating and repossessing the car. The technology can also be used as an optional service to the consumer as long as the SID “is not a condition of the purchase or sale agreement for the vehicle.”¹⁹⁹ California punishes violators “by [charging] a fine not exceeding one thousand dollars.”²⁰⁰

States approving the use of SIDs should follow the California statute but prohibit the lender from using them as a condition for the installment credit agreement. As mentioned earlier, an SID tells nothing to the lender about whether a borrower is financially capable of making the monthly loan payments. Therefore, prohibiting the use of an SID as a condition for the installment credit agreement ensures the lender gives credit to the borrower commensurate to the borrower’s ability to pay. This further strengthens the lender’s credit risk management processes. Additionally, rather than a maximum fine of \$1000, states should charge a minimum fine of \$1000 with the ultimate fine depending on the facts and circumstances of a given case.²⁰¹ With the current boom in subprime auto lending and auto dealers joining the cause of SID technology, such a statute would more effectively mitigate the risk of careless credit lending on the part of subprime auto lenders. States will also be able to maintain their sovereignty in directly regulating auto lending practices within their respective borders while leaving oversight functions to the federal government.

V. CONCLUSION

Subprime auto lenders are increasingly using the installation of SIDs to justify granting credit to subprime borrowers. A borrower’s financial ability to pay a loan, however, is not connected to whether an SID is installed in the borrower’s car. In the long run, borrower delinquencies, which have already begun to increase, are bound to further rise. The risk of default extends to other areas of the economy because auto lenders package and sell these risky loans to secondary market investors. Although the subprime auto lending market is but a fraction of the financial sector, the lessons from the subprime mortgage crisis indicate that regulators should pay close attention. To prevent the ripple effects of a market failure from negatively impacting the economy, federal and state regulators should proactively pass legislation and undertake examination procedures that ensure subprime auto lenders keep the decision to install an SID in a borrower’s car separate from the determination about whether the borrower can actually fulfill the contractual loan payments.

199. CAL. CIV. CODE § 2983.37(a)(1)(B)(i) (West 2012 & Supp. 2015).

200. *Id.* § 2983.37(c).

201. For example, states could charge violators more than \$1000 where there is evidence that the violator also engaged in predatory lending.