

# As laws on repossessed auto sales ease, economists show consumer access to credit jumps

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A key change in Brazilian law simplifying the sale of repossessed cars has enabled low-income borrowers in the country to get credit more easily and buy newer, more expensive cars, a new study shows.

The study from the [Consortium](#) on Financial Systems and [Poverty](#) examines car loans from one of Brazil's leading banks before and after a 2004 [law](#) that enabled banks to sell repossessed cars quickly without going through a lengthy court process.

"As far as we know, this research is the first to provide evidence that stronger creditor rights lead to a 'democratization of credit' – as lower-income, riskier borrowers were now granted a loan," the research team of economists note.

The study, which is described in a working paper titled "Repossession and the Democratization of [Credit](#)," was made by Juliano Assunção and Fernando Silva of Pontifícia Universidade Católica do Rio de Janeiro (PUC-Rio) and Efraim Benmelech of Harvard University.

The researchers examined 17,000 loan contracts from the period August 2003 to July 2005 – one year before and one year after the change in the law. According to the Brazilian central bank, credit for vehicles grew from R\$34.7 billion (US\$11.5 billion) in August 2004 to R\$60.2 billion (US\$27.9 billion) two years later.

Prior the change in the law, banks were able to repossess vehicles when borrowers defaulted on their loans but could not resell them until after a trial. As the auto market in [Brazil](#) grew, this came to mean a delay of two to three years, which discouraged banks from making car loans.

By eliminating the need for a trial to resell the car, the change in the law encouraged [banks](#) to expand the market for car loans to riskier, low-income borrowers, even though this led to a higher rate of default and repossession.

"Ultimately, the law has reformulated relationships among borrowers, creditors, and courts," the economists wrote. "Borrowers and creditors now engage in direct relationships, and courts play a significant role only when borrowers explicitly request it. The law avoids unnecessary trials, reduces the reliance on courts, and increases the enforceability of auto loan contracts."

The change also enabled consumers to buy newer, more expensive cars. The banks' ability to sell foreclosed cars encouraged them to offer better contractual terms, including longer maturities and lower spreads. This in turn allowed borrowers to spend more on cars.

The use of micro-level data enabled researchers to separate the direct effect of the legal change on contracts from the composition effect that resulted in increased lending to riskier [borrowers](#). This is the "democratization of credit" identified by the researchers. The strengthening of the ability of lenders to foreclose, repossess, and sell assets increased the supply of credit to those who need it most.

The change did lead to higher rates of delinquency and default. The researchers found an increase of approximately 30% in late payments and defaults.

## Provided by Consortium on Financial Systems & Poverty

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