

Comments
to the
Consumer Financial Protection Bureau
regarding
Consumer Financial Products and Services Offered to Servicemembers
Docket No. CFPB-2011-0016
76 Fed. Reg. 54998 (Sept. 6, 2011)
by the
Consumer Federation of America
September 20, 2011

Consumer Federation of America (CFA)¹ welcomes the opportunity to comment on financial products sold to servicemembers and their families to assist the Consumer Financial Protection Bureau carry out its mission. CFA assisted the Department of Defense in studying the impact of predatory lending on servicemembers for the report to Congress requested by Senator Elizabeth Dole in 2006, worked to win passage of the Talent-Nelson amendment to the John Warner National Defense Authorization Act of 2007, and participated in the Department of Defense rule-writing docket to implement the Military Lending Act (MLA) effective October 1, 2007. The MLA, which prohibits abusive credit practices, requires responsible lending, and caps the cost of covered credit (initially defined by DoD regulations to include payday, car title, and tax refund anticipation loans), is a ground-breaking federal protection for military borrowers. We look forward to working with CFPB as it addresses additional credit and financial service products and practices that are harmful to servicemembers.

Servicemembers are a prime market for credit providers that cluster around military bases and promote credit targeted at the military via the Internet. Although moderately-paid, servicemembers have a steady paycheck and are required to have bank accounts into which their pay is direct deposited. They are subject to the Uniform Code of Military Justice and must keep their finances in order to maintain security clearances. Servicemembers can be relatively inexperienced consumers with young families and pent up demand for products and services that can be purchased on credit. They can pay for credit via the military allotment system which makes lending to these borrowers low-risk for retailers and loan companies and convenient to servicemembers who move often, but not without risks for borrowers.

In recognition of the five-year anniversary of Congressional passage of the Military Lending Act, CFA has been studying credit products sold to servicemembers, focusing on loans that do not fit

¹ Consumer Federation of America is an association of nearly 300 nonprofit consumer groups that was established in 1968 to advance the consumer interest through research, advocacy and education. Comments by Jean Ann Fox, director of financial services, CFA.

the definitions for “covered credit” in the DoD rules implementing the Military Lending Act and on loans sold specifically to servicemembers to be paid from bank accounts or through the military allotment system. These include bank overdraft loans and direct deposit cash advances which are sold to bank customers regardless of military status. While the short comment period does not permit a comprehensive review of military issues with financial services, CFA can provide preliminary information to respond to two questions in this docket.

Q 1: What consumer financial products and services are currently offered to or utilized by servicemembers and their families?

Mandatory bank account ownership makes servicemembers eligible for bank payday loan products. Overdraft loans and direct deposit advances cost triple-digit rates, are deposited into the borrower’s bank account, are paid through unilateral withdrawal of funds from the account, and are due to be paid in full in just days for overdrafts and up to 35 days, but typically much sooner, for direct deposit advances. Low-to-moderate income consumers disproportionately use overdrafts, as do young consumers who more often use debit cards instead of cash to pay for purchases.

Overdraft Loans

Banks loan money when they cover transactions on insufficient funds and charge a fee, however Federal Reserve rules exempt banks from complying with federal credit protections. CFA recently surveyed the largest fourteen banks’ overdraft fees and practices and found that the typical fee is \$35.² Two-thirds of large banks charge more than one fee when an overdraft is not repaid in just days. A consumer who overdraws by just \$5.01 will be charged \$68 by BB&T if it is not repaid in just seven days. All but one surveyed bank sets a limit on the number of overdraft fees charged per day, ranging from three at JPMorganChase to ten per day at Fifth Third Bank. As a result a soldier with an account at one of these banks can be charged from \$99 at U.S. Bank to \$370 at Fifth Third Bank for just one day of overdrafts.

Overdraft loans, if the cost were computed as it is for a closed-end payday loan and included all fees incurred for a single \$100 overdraft repaid in two-weeks, cost triple to quadruple-digit interest rates. The equivalent APRs range from 910 percent to 3,250 percent, but the Federal Reserve has not required banks to disclose overdraft fees under the Truth in Lending Act or provided servicemembers and other consumers a means of comparing overdraft loans to other forms of credit. If an overdrawn consumer does not immediately bring the account to positive, the overdrafts and associated fees are repaid by set-off, with the bank deducting the total amount owed before the next deposited pay is available to spend on a family’s needs. As a

² Consumer Federation of America, “2011 CFA Survey of Big Bank Overdraft Loan Fees and Terms,” www.consumerfed.org/pdfs/OD-14BankSurvey-ChartAugust2011.pdf

result of these features, CFA and others label bank overdraft loans as a bank payday loan product. However, overdrafts are not defined as a “payday loan” under the DoD rules implementing the MLA.

This summer, CFA reviewed the fees and terms at all banks with branches on military bases to see if overdraft fees are charged and if customers are solicited to opt-in to pay overdraft fees on debit card point of sale purchases and ATM withdrawals. Our preliminary findings indicate that over 80 percent of banks with branches on military bases ask consumers to opt in to pay overdraft fees that range from \$18 to \$38.50 per overdraft for single debit card purchases and/or ATM withdrawals. For example, Armed Forces Bank³, with branches on many bases, charges \$25 per overdraft item for any overdraft of \$5 or more or \$10 total overdrawn in one day. The daily limit on overdraft fees at this bank is \$125. A \$25 fee to borrow \$100 for two-weeks, if computed as a payday loan, comes to 650 percent APR. Fort Sill National Bank⁴ charges an \$18 per overdraft fee and permits up to seven fees in one day for a total of \$126.

Direct Deposit Advance Loans

A growing number of banks make payday loans to their customers, called direct deposit advances. These small loans are deposited into the consumer’s account on request and are repaid out of the next deposit to the account or within 35 days at the most. The typical direct deposit advance costs \$10 per \$100 borrowed or 365 percent APR based on a typical loan term of ten days. The Center for Responsible Lending found that these short-term bank loans lead to the same debt trap as payday loans, with bank payday loan customers averaging 16 loans per year, leaving them in debt for 175 days per year.⁵ Bank payday loans carry the same high cost, short term, debt-trap features as non-bank payday loans. Bank payday loans are not banned by the MLA rules because the loans are structured as purportedly open-end credit while the Department of Defense rules define payday loans as closed-end credit.⁶

Of the large banks marketing direct deposit advance loans to consumers, three have branches on military bases and a fourth bank markets special account features to military customers. CFA contacted at least one branch on base per bank with a direct deposit advance product to ask if this loan is available to servicemembers and got an affirmative response. While we have not confirmed that servicemembers on those bases are using direct deposit advance loans, we

³ www.afbank.com/optin, visited 9/20/11

⁴ www.fsnb.com/pages/overdraft.html, visited 9/20/11

⁵ Center for Responsible Lending, “Big Bank Payday Loans,” July 21, 2011.

⁶ CFA Fact Sheet, “Predatory Lending Protections for Servicemembers,” October 1, 2007, at <http://www.consumerfed.org/pdfs/MIL-Fact-Sheet-Final-Regs.pdf>. Whether bank payday loans truly meet the definition of open-end credit is not clear.

urge CFPB to work with other regulators to make sure that payday loan equivalents that would violate the MLA are not made available to servicemembers by banks whether on-base or off.

CFA urges CFPB to work with the Department of Defense to extend the protections of the Military Lending Act to payday-loan type loans made by banks to servicemembers and their families, in addition to prohibiting unfair, deceptive and abusive bank loan practices and to applying federal credit protection laws to these products to benefit all consumers.

Installment Lenders That Target Servicemembers

As we noted in comments filed with the Consumer Financial Protection Bureau in the docket to determine “larger” non-bank participants, installment loan companies, such as Pioneer, Omni, and Patriot that specialize in loans to servicemembers should get close scrutiny by CFPB. In defining “covered credit,” the Department of Defense did not include longer-term, unsecured installment loans in the first round of rule-writing. As a result, the installment loan companies that have offices near military bases, provide sales financing at retailers, and market loans online exclusively to the military are not covered by the MLA rate cap or other consumer protections. Military installment lenders include:

Omni Financial (www.yesomni.com) is based in Nevada and makes loans of \$500 to \$10,000 for terms of 6 to 36 months to servicemembers with eight months or more left to serve. Omni lists branches in 17 states but CFA was only able to verify state licenses in nine states.

Patriot Loan Co. (www.patriotloanco.com) is owned by Security Finance and is based in South Carolina, makes loans from \$100 to \$1,000 and has branches in six states. Patriot Loan Company offers in-person military loans.

Pioneer Military Services (www.pioneermilitaryloans.com) is owned by Midcountry Financial Corp. and makes loans of \$500 to \$10,000 for up to 36 months. No APR is quoted on the company’s website for the origination fee and interest charged on loans. Pioneer has loan offices in 14 states and makes loans via the Internet. Pioneer also provides sales financing to retailers, including electronics, furniture, jewelry, travel, and auto accessory retailers.

Servicemembers worldwide who have access to the Internet can easily get into debt with online lenders. CFA recently surveyed online installment loan offers to servicemembers and found nine lenders that deal primarily or exclusively with servicemembers. Most of these lenders only make loans via the Internet. Borrowers at online military installment lender websites are not likely to find the cost of loans disclosed prior to an accepted application, however Armed Forces Loans quotes up to 87.5 percent while Omni Financial quotes 9.95 percent to 34.95 percent

cost to borrow. Loan size varies but loans in CFA's survey were all between \$100 and \$10,000 with up to 36 months to repay.

CFPB also should make military-only installment lenders a supervisory priority due to uneven supervision by states. This issue was raised in the Department of Defense Report to Congress, which noted a particular concern "with the lack of universal state licensing is that these companies do not have to comply with state laws covering disclosure, rate caps, fee limits, loan size and collateral requirements."⁷ As noted above, one military installment lender affiliated with a bank does not appear to be licensed in each state in which loans are made from stores. In some states that apply small loan laws to loans made to "residents," loan companies that only lend to non-resident servicemembers stationed in the state have in the past not been licensed or supervised by states. One online lender avoids this problem. Military Funding USA, Inc. notes on its website (www.loansmilitary.com) that "Loans are not offered to residents of CA, FL, GA, MT, NV, or WV or individuals stationed in states that consider members of the military stationed in those states to be residents of the state in which they are stationed." CFPB should work with state credit regulators to consistently regulate installment loan companies.

Q 2: What consumer financial products and services (and associated programs, policies, and practices) are tailored to the unique financial needs of servicemembers and their families or are marketed specifically to servicemembers and their families?

Although convenient, payment of commercial credit via **allotment** of military pay poses risks and raises issues for military borrowers, including over-extension of limited pay for discretionary purchases, leaving too little in the paycheck to cover necessities; credit extended without a full determination of ability to repay; and easy sale of over-priced merchandise to inexperienced buyers. Allotments are a form of wage assignment. The Department of Defense permits up to six allotments for payment of commercial credit with no limit on the proportion of the servicemember's income that can be obligated to payments. Theoretically, a sailor can "allot" all of his income to pay for purchases of electronics, car accessories, cash loans, furniture and jewelry. The payment is sent from DFAS to the processing bank for the creditor before the remaining paycheck is direct deposited to the servicemember's bank account. This makes paying for "wants" the priority over other monthly budget obligations, such as groceries. Payment by allotment also makes credit more readily available to young servicemembers who have not built up strong credit scores. One military lender, Pioneer, claims to have a

⁷ Department of Defense, "Report on Predatory Lending Practices Directed at members of the Armed Forces and Their Dependents," August 9, 2006, p. 17-19.

proprietary scoring model which permits more servicemembers to get loans than otherwise would qualify under conventional credit scoring models.⁸

Commercial lenders use the military allotment system to take a “wage assignment” to insure repayment of loans from military pay prior to direct deposit of each paycheck into the servicemember’s account at his or her bank or credit union. When consumers apply for credit to be paid via allotments, lenders ask for the applicant’s Leave and Earnings Statement (LES) which is easy to access online via the MyPay website. The LES verifies income and shows the remaining length of service. While lenders may offer several payment options, payment by allotment is typically the first option. Some lenders also take payment by debit from borrowers’ bank accounts and offer the option of payment by allotment backed up by an ACH authorization so that payment is taken from the servicemember’s bank account should the allotment fail or be insufficient.

FirstNet, a division of First Citizens Bank in Kentucky, is the largest allotment payment processor and is used by about 1,000 lenders to process allotment and electronic payments.⁹ As detailed in a letter from New York Attorney General Cuomo to Secretary of Defense Robert Gates, sales companies that finance purchases through allotment open a “savings” account in the servicemember’s name at First Citizens Bank to receive the military allotment payments from DFAS and require customers to execute transfer authorizations so monthly allotment payments are automatically paid to the lenders. Consumers do not have a choice of the bank that handles the allotment and, alleged in the New York case, were not told about bank charges for processing payments.¹⁰

Allotments sent to First Citizens Bank are cumulative to pay multiple lenders and First Citizens Bank splits up the payments to each creditor. Since military personnel are paid twice a month, half the monthly credit payment is sent to the bank each payday. The bank’s paperwork provides instructions for the servicemember to access <https://mypay.dfas.mil/mypay.aspx> to set up allotments. To stop an allotment is a two-step process, with the servicemember required to both fax a letter to FirstNet authorizing the bank to discontinue payments to that company, plus a requirement to contact payroll to have the allotment stopped or decreased. If

⁸ <http://www.pioneerretailcredit.com/faq.cfm>, visited 9/14/2011. “While most retail finance companies use conventional credit bureau scoring, we utilize our own proprietary Military Scoring Model (MSM) designed especially for military customers. This approach allows us to approve more military customers while increasing your sales.”

⁹ Shannon Leonard-boone, “Elizabethtown bank boosts bottom line with military allotment service that makes life easier for troops,” Lane Report, March 2010 viewed at www.lanereport.com/articles/article.cfm?id=1136.

¹⁰ New York Attorney General Andrew Cuomo letter to Dr. Robert M. Gates and John McHugh, Regarding *The People of New York vs. Frisco Marketing of NY LLC d/b/a SmartBuy and SmartBuy Computers and Electronics; Integrity Financial of North Carolina, Inc.; GJS Management, Inc.; Rome Finance Co., Inc.; Rome Finance Co. (GA), LLC, Britlee, Inc. d/b/a Military Zone and Smartbuy, et al.*, May 10, 2010.

a borrower fails to stop the allotment, part of his or her pay goes to the savings account at the bank in Kentucky even if it is not being disbursed to pay a creditor.

The allotment system was developed before the widespread availability of electronic payment options to facilitate payment by servicemembers who move regularly and may be overseas. In the modern electronic world, the allotment system may have outlived its usefulness, lacks the same protections as other electronic payments, and may pose undue risks to servicemembers. CFPB should provide information and advice on paying by allotment, work with bank regulators to make sure banks that partner with third-party companies to provide payment services deal fairly with consumers and provide full disclosures. CFPB should work with DoD to improve safeguards for payment of commercial credit by servicemembers. The Military Lending Act requires that payment by allotment be voluntary; however, that requirement applies only to the three types of loans that were defined as “covered credit” by the Department of Defense. CFPB should help ensure that payment by allotment is truly voluntary to pay for all types of commercial credit and should work with DoD to reconsider whether the availability of allotments continues to be necessary and to serve the needs of servicemembers.

Credit repaid by **electronic fund transfers** from servicemember’s accounts should also be scrutinized by CFPB. Since servicemembers are required to have accounts at depository institutions to receive direct deposit of their military pay, any loans based on repayment by electronic funds transfer are important to monitor for compliance with the Electronic Fund Transfer Act (EFTA) and Reg E. Federal law prohibits conditioning the extension of credit on a requirement that periodic payment loans be repaid electronically and gives borrower’s the right to stop payment. Borrowers should be able to revoke authorization to electronically pay any installment or the remainder of a loan. CFPB should look closely at online loan offers, loan contracts, and consumer complaints to confirm that payment via electronic fund transfer, especially for military borrowers, is voluntary and that revocations of authorization are being honored.

Although the Federal Register notice did not ask for examples of harmful loans specifically targeted at military borrowers, we provide some examples of loopholes in the MLA rules and other problematic forms of credit marketed to servicemembers.

Credit providers that make loans similar to payday and car title Loans as defined by the DoD MLA regulations

It is easy to get around the MLA. The DoD rules implementing the Military Lending Act defined covered payday and car title loans as closed-end credit. Payday loans are defined as loans secured by a check held for future deposit with a term of up to 91 days. A car title loan is defined as a loan secured by the title to the borrower’s vehicle with a term up to 181 days. As a

result, lenders can charge more than 36 percent and secure loans with checks, car titles, and electronic access to bank accounts, simply by structuring the loan as “open-ended” or for a longer repayment term than the MLA definition. CFPB should pay close attention to any lender that claims to be exempt from the MLA as a result of tinkering with loan terms.

For example, Military Financial (www.militaryfinancial.com) is an Internet-only military lender, based in Delaware. It will loan up to 40 percent of a servicemember’s take home pay. Loans are structured as an “open-end” Rapid Line of Credit. Although loan costs are not disclosed on the website, CFA has on file a 2008 contract that quotes 584.68 percent APR. Military Financial notes in its FAQs that it is not required to comply with the Military Lending Act cap of 36 percent MAPR since that cap only applies to closed-end payday loans.¹¹

CFPB should investigate online lenders that target military borrowers to determine if lenders comply with the MLA rules. A superficial review of online loan applications does not verify whether lenders are screening out covered borrowers. In June 2011, CFA conducted a Google search using the terms “car title loan apply,” and found thirteen websites that market title loans to consumers. Only three of the sites listed an actual or an estimated figure for APR or fees to reveal the cost of borrowing prior to a completed loan application.

Only two of the thirteen asked if the borrower is a military servicemember although some websites have multi-step application processes where the lender may ask about military status at a later point in the application. Since the MLA as implemented by DoD regulations defines “covered credit” to include car title loans, CFPB should work with DoD to ensure all online and storefront car title lenders comply with MLA rules and do not evade those rules by exploiting loopholes in definitions.

Conclusion

Protecting servicemembers should be a priority for CFPB and we urge the agency to work closely with the Department of Defense and other financial regulators to make sure lenders that target these consumers comply with consumer protection requirements, make full and accurate disclosures, and lend responsibly. CFPB should take action to protect consumers from payday-loan type bank products and to enforce the Electronic Fund Transfer Act prohibition against conditioning the extension of credit on a requirement to make electronic payments. CFPB should apply the Military Lending Act requirement that payment by allotment be truly voluntary to all forms of credit and should work with DoD and bank regulators to reexamine whether allotments pose on undue and unnecessary risk to servicemembers.

¹¹ <https://www.militaryfinancial.com/Faq.aspx> visited 9/20/11

CFA will provide more information on lenders that impact or target servicemembers later in 2011.