



Consumer Federation of America

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The Military Lending Act Five Years Later

**Impact On Servicemembers, the High-Cost Small Dollar
Loan Market, and the Campaign against Predatory Lending**

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Consumer Federation of America

May 29, 2012

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Five years ago the Department of Defense requested and Congress enacted ground-breaking consumer protections against predatory lending to safeguard active-duty servicemembers and their families. The Department reported to Congress that "...predatory lending undermines military readiness, harms the morale of troops and their families, and adds to the cost of fielding an all-volunteer fighting force."¹ In response, Congress enacted and President Bush signed into law the Talent-Nelson amendment included with strong bi-partisan support in the John Warner National Defense Authorization Act of 2007. The resulting Military Lending Act and its implementing regulations adopted by the Secretary of Defense took effect October 1, 2007.

The Military Lending Act was the end result of a lengthy campaign to protect military borrowers. Early in the last decade the spread of high-cost predatory lending with its harmful impact on borrowers collided with the growing demands on servicemembers and their families as America waged war in Iraq and Afghanistan while relying on an all-volunteer military force. Growing alarm about the harmful effects of triple-digit rate loans from commanders, financial counselors, relief societies and consumer advocacy organizations, and leadership by Senator Elizabeth Dole resulted in a requirement from Congress for the Department of Defense (DoD) to report on the impact of predatory lending on servicemembers.

The Department of Defense conducted a detailed examination of the financial welfare and use of high-cost small dollar credit products by servicemembers as part of the Defense Manpower survey, collected case histories from financial counselors on military bases, surveyed available responsible small dollar credit products available from financial institutions that serve bases, and

¹ Department of Defense, *Report On Predatory Lending Practices Directed at Members of the Armed Forces and Their Dependents*, August 9, 2006, p. 9. [www.defenselink.mil/pubs/pdfs/Report to Congress_final.pdf](http://www.defenselink.mil/pubs/pdfs/Report_to_Congress_final.pdf)

described financial literacy programs provided to help servicemembers manage their financial lives. Academic experts provided maps that showed the concentration of high-cost lenders around military bases across the country. As required by the Dole study provision, DoD also met with representatives of military charities, consumer advocacy organizations, and federal banking regulators to collect information for the report which was issued in 2006.

The Senate Banking Committee held a hearing on the DoD Report to Congress and bi-partisan support developed for enacting federal protections to safeguard servicemembers and their families from predatory lending.² In 2006 Congress enacted the Talent-Nelson amendment as part of the John Warner National Defense Authorization Act of 2007.³ For the first time in modern history, Congress set a national usury cap for credit and banned risky features of credit products for loans made to active-duty servicemembers and their dependents. These reforms were backed by the Department of Defense, military and veterans groups, and consumer and community advocates who work on credit reforms. A bi-partisan majority of Senators successfully urged the conference committee to include the Talent-Nelson amendment as part of the Defense Authorization Act.

The Military Lending Act set an inclusive 36 percent annual rate cap for loans made to covered servicemembers and their dependents, prohibited securing loans with checks, electronic access to bank accounts, vehicle titles, or allotment of military pay, and required that servicemembers have access to the judicial system to resolve complaints. Only mortgages and auto finance loans were excluded from coverage of the act, with the Department of Defense authorized to write rules to define the types of credit to be subject to these protections.

Rules to implement the Military Lending Act (MLA), written by the Department of Defense (DOD) after opportunity for comments from the public, took effect on October 1, 2007. DoD defined three products as “consumer credit” for purposes of applying rate caps and other protections in the law, including payday loans, car title loans, and tax refund anticipation loans, but did not include other forms of high-cost or harmful credit that had been included as problematic in the DoD Report to Congress, such as military installment loans and rent-to-own transactions.

Five years after enactment of this landmark legislation, the Annie E. Casey Foundation requested that Consumer Federation of America prepare a report on the impact of the Military Lending Act on military consumers, on opportunities for additional protections, and on the larger policy debate over rate caps and credit protections.⁴

² Committee on Banking, Housing, and Urban Affairs, Hearing on the *Department of Defense Report on Predatory Lending Practices Directed at Members of the Armed Forces and Their Dependents*, September 14, 2006.

³ P.L. 109-364

⁴ CFA appreciates funding for this project from the Annie E. Casey Foundation but takes full responsibility for the report contents and opinions expressed. CFA thanks law fellows Bryan Jinks and Chris Matthews for invaluable assistance in research for the report; former staff Catherine B. Bourque for surveys; and consultants Darci Langham

I. Creditors and Consumer Credit Covered by MLA Rules

In brief outline form, this section describes the products and protections covered by the Military Lending Act as implemented by rules adopted by the Department of Defense.

The Department, in its rules to implement the MLA, narrowly defined three types of loans as “consumer credit” to be subject to the protections of the MLA.

- **Payday Loans** (at stores or made via the Internet or telephone/fax)
 - Loans up to \$2,000 (one or more loans)
 - Closed-end (single advance of credit over fixed term)
 - Term of 91 days or less
 - Based on check held for future deposit or electronic access to account for future payment

- **Vehicle Title Loans**
 - Term of 181 days or less
 - Closed-end
 - Secured by title to a registered motor vehicle owned by a covered borrower (except to buy the car)

- **Tax Refund Anticipation Loans**
 - Closed-end credit
 - Tax refund goes to creditor to repay loan

A. Credit Not Covered per Military Lending Act

1. Residential mortgages, including refinancing, home equity loans or lines of credit, and reverse mortgages, excluded by the MLA.
2. Credit to finance the purchase or lease of a vehicle, and secured by the vehicle being purchased or leased, excluded by the MLA.

B. Credit Not Covered by MLA under DoD Rules

3. Open-end credit, including all credit cards, bank overdraft lines of credit, and any truly open-end payday or vehicle title loans. (“Open end” involves repeat use of credit without approval necessary, no fixed term to repay, charge based on outstanding balance)
4. Any debt to a bank that can be paid by set-off of deposited funds, such as overdraft loans. (Set-off means the bank withdraws payment directly from the account per standard account contract terms.)

and Graham McCaulley for their case studies at bases. CFA also thanks the Air Force Aid and Navy-Marine Corps Relief Society and on-base financial counselors for sharing their experiences with us.

5. Any credit not subject to Truth in Lending Act disclosures, such as overdraft loans.
6. Installment loans with terms longer than 91 days, including all military installment lenders, or all installment loans not secured by a check or electronic access to an account.
7. Rent to own transactions or retail sales credit.
8. Any credit transaction to finance the purchase or lease of personal property when the credit is secured by the property being purchased.
9. Credit secured by a qualified retirement account.

C. Covered Borrowers

1. Regular or reserve member of the **Army, Navy, Marine Corps, Air Force or Coast Guard**
2. Serving on active duty under a call or order that specifies longer than 30 days
3. Member serving on Active Guard and Reserve Duty (10 U.S.C. 101(d)(6))
4. Card-carrying dependent of active duty military. (Member's spouse, child (38 U.S.C. 101(4)), or individual who gets over half support for 180 days immediately preceding an extension of credit)

Lenders must use standard loan application language to determine if borrowers are covered servicemembers or dependents. Lenders can query a DoD database to verify active-duty status.

D. Protections That Apply to "Covered" Consumer Credit: Payday Loans, Car Title Loans, Tax Refund Loans

36% Annual Interest Rate Cap, including most fees (but not late or default fees) and insurance premiums, stated as the Military Annual Percentage Rate (MAPR)

Ban on securing loan with a personal check or other access to bank account, title to a personal vehicle, or military allotment (Service member can choose to pay other types of credit by allotment.)

No Prepayment penalties

No Roll-overs, renewals, refinancing or consolidation unless the renewal is at better terms for the borrower, such as a lower cost

Ban on mandatory arbitration clauses, waiver of legal rights, and onerous legal notice in case of dispute (Borrower cannot sign away legal rights.)

Mandatory disclosures orally and in writing before credit is issued:

**Military Annual Percentage Rate
Truth In Lending Act required disclosures
Clear description of payment obligations**

For loans made via the mail or Internet, oral disclosures may be made by providing a 1-800 #.

E. Federal vs. State Laws

Military Lending Act and DOD regulations apply unless a state law provides additional protection to the borrower. (State rate cap can be lower than 36%, for example, or cover open-end payday loans.)

States must enforce state laws to protect non-resident Service Members stationed in their state. This provision has been applied only to products defined as “consumer credit.”

See: 32 CFR Part 232, Limitations on Terms of Consumer Credit Extended to Service members and Dependents; Final Rule; Federal Register: August 31, 2007 (Volume 72, Number 169), page 50579-50594.

F. How CFA Conducted the Military Lending Act Project

For this report, CFA prepared case studies about the impact of the MLA at three military bases, including in Jacksonville, Florida; Fort Leonard Wood, Missouri; and San Diego, California, and met with financial counselors and relief society staff at the Norfolk Naval Base and Langley Air Force Base in Virginia. CFA commissioned updated maps of the location of high-cost lenders near a sample of military bases by the professor who supplied maps for the Department of Defense Report to Congress in 2006. We surveyed state credit regulators and federal bank regulatory agencies, reviewed examination manuals issued by the Consumer Financial Protection Bureau, and requested input from consumer attorneys.

To update information on the high-cost small dollar loan market, CFA surveyed Internet payday loan websites, reviewed state car title loan legal status, and updated information on refund anticipation loans. CFA reviewed states' authority to enforce federal credit laws, collected information on states that have enacted laws empowering state regulators to enforce the Military Lending Act, and inquired into the use of Armed Forces Disciplinary Control Boards at bases as a financial supervision tool. CFA studied the use of allotments to pay for loans and credit purchases and surveyed the major installment loan companies that target military borrowers. CFA surveyed banks with branches on military bases to gauge the extent of payday-loan-type products offered by banks to servicemembers, including overdraft loans and direct deposit advance loans. And, finally, CFA reviewed the policy landscape changes since 2006 to evaluate the influence of the MLA on the debate over capping interest rates for loans and curbing abusive lending tactics.

CFA was not authorized to survey servicemembers directly or to have access to Defense Department polling or Defense Manpower surveys of servicemembers. While military financial counselors at specific bases shared their experiences with CFA consultants, we were not able to systematically survey all base staff or to require feedback from staff. We recommend that the Department of Defense, in cooperation with the Office of Servicemember Affairs at the Consumer Financial Protection Bureau, conduct an evaluation of the impact of the Military Lending Act as implemented by regulations and an assessment of credit products and practices that cause financial stress today for servicemembers and their families. Such a study, based on direct access to military borrowers, would form the basis for refining and expanding rules implementing the Military Lending Act and related work to strengthen protections for all consumers that would also benefit servicemembers and their families as well as military retirees and returning veterans from recent conflicts.

II. Executive Summary: Findings and Recommendations

A. Finding: MLA Largely Successful in Curbing Abusive Lending as Defined by DOD

The Military Lending Act was narrowly applied to three specific products that fit the DoD definitions of a covered payday, car title, or tax refund loan. To the extent products met these definitions, the law has been largely effective in curbing predatory payday, car title, and tax refund lending to covered borrowers. Mapping of the locations of lenders near Camp Pendleton in California shows a 70 percent drop in the number of payday loan outlets after the MLA took effect. Relief societies report a sharp drop in the number of clients needing financial assistance as a result of using payday or car title loans. State regulators report few violations with the lenders they supervise. Compliance is more problematic with car title lenders and internet payday loan providers than for storefront payday lending, due in part to attempts by some online lenders to avoid state enforcement of usury caps and credit laws. However, the impact of the federal law prohibiting certain payday and car title loan products is very pronounced.

The Military Lending Act rules also applied a 36 percent inclusive rate cap to refund anticipation loans (RALs) made by banks via tax preparers. Since these loans cost considerably more than 36 percent, RALs are no longer to be made to covered service members. The federal prudential regulators that supervise the banks in this market report compliance with the MLA and CFA has not detected RAL lending in violation of the law. On the other hand, only one RAL provider experimented with limited availability of low-cost RALs the first year after the law took effect. Instead of providing low-cost RALs that comply with MLA rules, banks simply left that market. As detailed below, this end to RAL lending did not result in an increase in servicemembers seeking VITA assistance on base to prepare and file tax returns, but did result in the increased purchase of refund anticipation checks as a means to defer payment of tax preparation fees. RALs made by banks ceased to exist at the end of the 2012 tax season, following supervisory action by federal bank regulators. In our opinion, the DoD designation of refund anticipation loans as harmful and unnecessary credit added support to actions taken by the IRS, the Comptroller of the Currency, and the Federal Deposit Insurance Corporation to terminate this product for all Americans.

The protections of the Military Lending Act only apply to active-duty servicemembers and reservists and their dependents, not to inactive personnel, retirees, or veterans. As young veterans return home from the conflicts in Iraq and Afghanistan, they are no longer insulated from predatory lending but face the disruptions of reentering the civilian economy. Military retirees who live on fixed incomes need the same protections from abusive credit terms. Credit counselors and relief societies told CFA that MLA protections should apply to these former servicemembers. This can be accomplished either by extending MLA protections to all Americans or the MLA coverage can be extended to protect all servicemembers, retirees and veterans.

Recommendation: The Department of Defense should conduct an internal study of servicemembers, financial counselors, and legal assistance/JAG officers to ascertain the impact of the current set of MLA rules on the use of defined products, problems caused by similar and emerging products, and the use of allotments to pay for commercial credit. The Defense Manpower Study quoted in the 2006 Report to Congress should be replicated to learn more about current credit problems for servicemembers and their families. MLA protections should cover all servicemembers, retirees, and veterans. A Congressional mandate for such a study would provide a framework and timeline and result in a public document to guide policymakers.

B. Finding: Restrictive definitions of “consumer credit” in DoD rules left loopholes to be exploited.

Lenders have exploited loopholes in the definitions of covered credit, such as styling a payday or car title loan as open-end credit or setting a loan term slightly longer than the definitions cover, to make high-cost loans to servicemembers. In some cases, loan terms in state laws put these loans outside the DoD definitions, such as Colorado’s six-month minimum term for a payday loan. The trend in internet payday lending is toward longer-term “installment” payment terms which places these triple-digit rate loans outside the 91-day term definition in the DoD rules. Exploiting definitional loopholes has been most problematic with an online payday lender and in states where high cost loans are not prohibited under state law.

Recommendation: DoD should initiate a new round of rule-making to modify definitions of covered credit in order to provide consistent protection for loans based on current product configurations. This includes removing the time-limits in definitions for payday and car title loans, and applying the rules uniformly to open and closed-end loans.

C. Finding: Problematic Credit Products Not Included in Covered Credit Definitions

Some credit products described as problems for servicemembers in the DoD Report to Congress were not included in DoD’s initial consumer credit definitions, including military installment loans and rent-to-own or other retail installment sales financing. As a result, servicemembers are still exposed to extremely high rates and risky forms of security, inconsistent supervision at the state level, and can still have pay drained by military allotments when borrowing or financing purchases with these creditors. The case study in San Diego revealed retail installment sales tactics that exploit the use of allotments and fail to provide buyers with cost information necessary to make informed decisions. The notorious SmartBuy retail operation near some military bases would not have been curbed by the MLA due to the narrow definitions of “consumer credit” as set by DoD.

Recommendation: DoD rule-making should add rent-to-own and retail installment financing to “covered” credit to add protections in the MLA, notably the use of allotments to pay for credit. Longer term unsecured installment loans should be covered by the protections of the Military Lending Act.

D. Finding: Bank Credit Products Similar to Payday Lending Excluded by DoD Rule

The Department of Defense's first set of regulations to implement the Military Lending Act specifically excluded several credit products with the same debt trap characteristics of covered payday loans, namely overdraft loans and direct deposit advance loans made by banks. In the first instance, the rules excluded any credit not required to comply with Truth in Lending Act disclosures or that are repaid by set-off from the borrower's account. In the second instance, DoD rules defined covered payday loans as closed-end credit while bank direct deposit advance loans are styled as open-ended. As a result, banks with branches on bases or that market accounts to the military off-base can and do make loans at triple or quadruple-digit rates that trap consumers in repeat borrowing and are secured by the next direct deposit of military pay to bank accounts. CFA surveyed banks with on-base branches and found that over 90 percent of banks permit accountholders to opt-into extremely expensive overdraft loans. Three of the four banks offering direct deposit advance loans at payday-loan rates have branches on bases.

Recommendation: DoD, CFPB, or Congress should close loopholes in definitions of covered credit to apply consistent protections to similar products. For example, open- and closed-end payday loans should be subject to the same rules. Another way to achieve a level playing field between bank and nonbank payday lenders is for CFPB to revise its rules to define all single payment loans as closed-end credit, thereby bringing bank direct deposit advance loans under the DoD definition of a covered payday loan. In the meantime, base commanders that negotiate agreements with banks with branches on military bases should prohibit on-base financial institutions from offering overdraft opt-in for debit card purchases and ATM withdrawals or from making direct deposit advance loans available to covered borrowers. CFPB should require banks to comply with the Truth in Lending Act when loaning money to cover overdrafts. Besides giving all consumers comparable cost of credit information, TILA coverage would bring bank overdraft loans under the DoD definition of a covered payday loan and protect covered borrowers from this extremely expensive credit.

E. Finding: MLA Ban on State Discrimination Against Non-resident Military Borrowers Not Effective

Congress intended for the Military Lending Act to put a halt to some states' failure to enforce state protections with loan companies that claim to be exempt from state consumer protections and supervision when loans are made only to nonresident military borrowers stationed in the state. While there are differences of opinion about the application of the non-discrimination provision of the law, DoD interprets it to mean that the non-discrimination provision only applies to products defined as "consumer credit," not to the military installment lenders that have long claimed to be exempt from state supervision. As a result, some military loan companies continue to operate outside state licensing and supervision when they claim to only lend to nonresident servicemembers.

Recommendation: DoD or Congress should clarify that the prohibition on discrimination under state law of nonresident servicemember borrowers is not permitted for any form of credit, not just those products defined as “consumer credit” by DoD. We believe that a plain reading of the statute provides the protection intended by Congress and should bring installment lenders that target non-resident servicemembers under each state’s consumer protections and usury or rate caps.

F. Finding: Enforcement Tools Need to be Updated to Uniformly Deliver MLA Protections

Enforcement authority needs to be reconfigured to include the Consumer Financial Protection Bureau and the Federal Trade Commission and to specifically authorize states to enforce the MLA and DoD regulations. While federal prudential regulators can enforce any law with the banks they supervise, the CFPB and FTC can only enforce enumerated statutes which do not include the MLA. As a result, the only federal agency with authority to supervise both large bank and all non-bank payday lenders can only report violations of MLA to others who may or may not have authority to take action. The FTC enforces credit laws for non-bank lenders and should be able to cite violations of the Military Lending Act. All states are not authorized to enforce federal laws, including the Military Lending Act. While five states have enacted specific authorization to enforce MLA and DoD rules, it is typically on a product by product basis.

Recommendation: The Consumer Financial Protection Bureau and the Federal Trade Commission should be given enforcement authority for the Military Lending Act by Congress. In the interim, a Memorandum of Agreement between the Department of Defense and CFPB could be explored to provide coverage. CFPB was created after the MLA was enacted and should be given the same authority that prudential regulators now have to enforce the law. CFPB should be added to the list of federal agencies to be consulted when DoD considers revisions to its rules. The CFPB Office of Servicemember Affairs is expected to be a key asset to DoD in monitoring credit problems for servicemembers and their families.

Recommendation: State legislatures should amend their state general credit laws to explicitly authorize state regulators and state Attorneys General to enforce the Military Lending Act and DoD regulations for all forms of credit subject to state jurisdiction.

G. Finding: Ban on Securing Loans with Allotments Does Not Apply to All Forms of Credit

The ban on securing loans by allotment from military pay only applies to the products defined by DoD as “consumer credit,” not to the installment loans and retail installment sales or rent-to-own transactions routinely paid by allotment. This form of wage assignment is not curbed by the Federal Trade Commission’s Credit Practices Rule which does not apply to payroll deduction plans. Defense Financial Accounting System (DFAS) rules permit servicemembers to obligate up to all of their military pay via allotment before pay is deposited to servicemembers’ bank

accounts. There is no limit on the types or reputations of lenders that can take payment directly from military pay by allotment. Because the ban on securing loans via allotment only applies to defined products, the protection provided by Congress is not being applied uniformly to all credit providers that use this form of payment.

Recommendation: No creditor should be permitted to make payment by allotment mandatory to receive credit. DFAS and DoD should reexamine the use of allotments for payment of commercial credit to determine if this program is still necessary in the era of electronic funds transfer from deposit accounts with federal protections. A Government Accountability Office study of the use and impact of mandatory and discretionary allotments to pay for consumer credit would be a positive first step.

H. **Finding: The Military Lending Act Has Had a Major Impact on the Policy Debate about Predatory Small Dollar Lending and Was a Major Factor In the Reversed Trend in States Legalizing Payday Loans**

The Military Lending Act continues to have a great impact on the policy debate about predatory small-dollar lending at both the state and federal level. Following the Congressional debate and bi-partisan support for the MLA's 36 percent annual rate cap, bills were introduced in both houses of Congress to impose a federal usury cap on all credit to benefit all borrowers. While these bills have yet to be enacted, the post-MLA period saw heightened attention to the cost and terms of credit. Congress gave the Consumer Financial Protection Bureau authority to supervise payday lenders, regardless of size, and for the first time established a federal agency to supervise both bank and nonbank lenders. Policy set by the federal Military Lending Act has been influential in state legislative and ballot campaigns to curb predatory payday lending. A key advocacy priority in all state credit reform campaigns has been that states should provide all Americans with the protections against predatory lending that Congress enacted for servicemembers and their families. So far voters in Ohio, Arizona, and Montana have gone to the polls to enact similar rate caps on small-dollar loans and no state has enacted legislation authorizing high-cost payday lending since the Military Lending Act was enacted.

Recommendation: Congress should extend the protections of the Military Lending Act to benefit all Americans. This would include a reasonable federal usury cap, a prohibition on securing loans with borrowers' bank accounts or vehicle titles, a ban on mandatory arbitration clauses, and safeguards for essential family assets and funds in deposit accounts. By extending MLA protections to all, creditors would no longer have to determine whether borrowers are defined as "covered" active-duty servicemembers and veterans and retirees would receive the same protections as active-duty personnel.

III. Servicemembers Still Need Protection from Abusive Credit Products

Just as the Department of Defense reported to Congress in 2006, servicemembers remain a prime market for credit providers that cluster around military bases and promote credit targeted at the military outside the base gate or via the Internet. Several factors make servicemembers attractive to lenders.

A. Servicemembers as consumers of credit

Servicemembers have a steady paycheck and are not likely to be laid off during a recession, yet the downturn in the economy since 2008 has left military families financially strained. In the 2010 Military Family Lifestyle Survey Report Analysis⁵, forty-one percent of respondents listed pay and benefits as one of top three military family life issues. Of that group of respondents, eighty-four percent said they have trouble making ends meet or felt military pay was low. Financial pressures unique to military families include non-reimbursed moving expenses, loss of spouse income due to frequent moves or deployment, and expenses of maintaining houses that cannot be sold when a servicemember is ordered to move to a new base. Of specific concern are the junior enlisted troops whose salaries are below the national poverty level.⁶

The recession and tough economy added stress to military families. The National Military Families Association lists three main financial stressors: Lack of employment opportunities for spouses who give up jobs due to change of station and who encounter barriers with licensing or other employment requirements in a new location;⁷ underwater mortgages and inability to sell the home when a servicemember gets orders to move; and veterans who have less of a safety net and encounter varying criteria for help from nonprofits that assist veterans.⁸

FINRA issued a report in 2010 analyzing the financial capability of U.S. military personnel which found that over a third of surveyed servicemembers report having difficulty making ends meet while only half have emergency savings.⁹ The study found that over twenty-five percent of military families owe more than \$10,000 in credit card debt and over half of enlisted personnel and junior non-commissioner officers reported making only the minimum payment on credit cards in some months. FINRA found that one in four servicemembers with checking accounts reported overdrawing their accounts while twenty-one percent used high-cost, non-bank borrowing such as payday, tax refund anticipation, or car title loans in the five years prior to the survey. Since the survey time period overlapped the implementation of the Military Lending Act

⁵ 2010 Military Family Lifestyle Survey, Blue Star Families, www.BlueStarFam.org, Falls Church, VA.

⁶ 2010 Military Family Lifestyle Survey, Blue Star Families, www.BlueStarFam.org, Falls Church, VA.

⁷ Military spouse unemployment rate of 26 percent is more than twice the national average. See Annie Gowen, "Troops Reach Out for Help Feeding Their Families," *The Washington Post*, November 23, 2011.

⁸ Interview with Katie Savant, National Military Families Association, November 17, 2011.

⁹ FINRA Investor Education Foundation, "Financial Capability in the United States; Military Survey – Executive Summary, page 12-13, October 2010.

which banned payday and car title loans, it is not possible to determine if those loans were obtained before the rules took effect October 2007.¹⁰

Servicemembers are required to have bank accounts into which their pay is direct deposited, making them susceptible to credit products based on access to deposit accounts, such as payday loans, overdraft loans, and direct deposit advances. A study of Air Force personnel found that “payday loan access produces welfare-reducing declines in job performance, financial distress, and/or severe misbehavior.”¹¹ While the Military Lending Act was implemented to prohibit some forms of payday loans to be made to covered military borrowers, protections are not uniformly applied to look-alike products.

Servicemembers can pay for loans and purchases via the military allotment system which makes lending to these borrowers relatively low-risk for retailers and loan companies and perhaps too convenient to servicemembers. Creditors with an allotment are first in line to be paid before military pay is deposited to the servicemember’s bank account. Allotments as payment for commercial credit are similar to wage assignments, but as payroll deduction payments are not covered by the Federal Trade Commission’s Credit Practices Rule which bans securing credit with wage assignments that cannot be cancelled.

Servicemembers are subject to the Uniform Code of Military Justice and must keep their finances in order to maintain security clearances. Financial missteps are a leading cause of problems for keeping a security clearance, especially as the Pentagon draws down force strength. As long as lenders or merchants know the borrower’s rank, they know the income level of the customer to help shape their offers. Creditors also know that they can call a borrower’s commanding officer to report non-payment. A CFA consultant was told by a lender outside the gates of Fort Leonard Wood in Missouri that a larger loan would be made to a soldier that her civilian husband since the lender could call the commanding officer to make sure the loan was repaid.

Servicemembers may have the only secure paycheck among their extended family, particularly in times of recession. CFA was told by counselors that servicemembers are often called on by their families to support family members or to pay for funerals for relatives. While we are not able to quantify the extent to which young servicemembers are called on to support more than their own immediate families, concern was raised about this at the bases we visited.

Servicemembers can be relatively inexperienced consumers with young families and pent up demand for products and services that can be purchased on credit. Close to two million children have one or both parents serving in the military, according to America’s Promise Alliance.¹²

¹⁰ FINRA Investor Education Foundation, “Financial Capability in the United States: Military Survey – Executive Summary,” October, 2010.

¹¹ Scott Carrell and Jonathan Zinman, “In Harm’s Way? Payday Loan Access and Military Personnel Performance,” Working Paper No. 08-18, Federal Reserve Bank of Philadelphia Research Department, August 2008.

¹² www.americaspromise.org/militaryfamilies, last visited December 6, 2011.

Forty-three percent of active-duty servicemembers have children (2009 Department of Defense Military Demographics Table).

Military bases are often located in states with lax consumer protections. States with the largest active-duty military populations are California, Virginia, Texas, North Carolina, Georgia, Washington, Florida, Hawaii, Kentucky, South Carolina, Maryland, Kansas, New York, and Illinois.¹³ At least one form of extremely high-cost credit is authorized in all but three of those states (NC, MD, NY).

Financial problems are a leading cause of complaints filed with the Federal Trade Commission's Military Sentinel complaint database. Military consumers report more problems with (1) identity theft, (2) debt collection, (4) mortgage foreclosure relief and debt management as four of the five highest complaint categories in the Military Sentinel database at the Federal Trade Commission for 2011. The latter two complaint categories ranked thirteenth highest for the general population, indicating that servicemembers continue to have disproportionate credit and debt problems.¹⁴ Younger servicemembers in E-1 through E-9 military pay grades filed 78 percent of complaints with Consumer Sentinel Network for those who reported their pay grade.¹⁵

B. Security Clearances Impacted by Financial Issues

The DoD Report to Congress justified its call for action against predatory lending in part due to the sudden jump in the loss of security clearances around bases in California which was attributed to the clustering of payday and other high-cost short term lenders around the gates to bases. As part of CFA's evaluation of the impact of the MLA, we looked at more recent information on the loss of security clearances due to financial problems.

While comparable information to the DoD Report to Congress on loss of security clearances due to financial problems is not available to us, a comparison of annual reports from the Department of the Navy Personnel Security Appeals Board provides one measure of the possible impact of curbing predatory payday, car title, and tax refund loans to active-duty servicemembers and their families. In 2006, the year before the MLA rules took effect, the Department of the Navy reported that fifty-seven percent of issues present in denied appeals of revoked security clearances for the Navy were due to financial problems. The next most significant issues were personal conduct (20%), criminal conduct (9%) and alcohol and drugs (9% combined).¹⁶ For 2010, the proportion of denied Navy appeals due to financial problems was forty-nine percent, with the next closest problem personal conduct at twenty-one percent.¹⁷ Even more markedly,

¹³ www.americaspromise.org/Our-Work/Military-Families/State-Data.aspx, last visited December 6, 2011, quoting the Department of Defense 2009 Demographics Report.

¹⁴ Federal Trade Commission, "Consumer Sentinel Network Data Book for January-December 2011," February 2012.

¹⁵ FTC Sentinel Report, page 18.

¹⁶ Department of the Navy, Personnel Security Appeals Board, CY 2006 Activity Report.

¹⁷ Department of the Navy, Personnel Security Appeals Board, CY 2010 Activity Report.

the number of denied appeals dropped from 426 in 2006 to 298 in 2010, despite the recession and financial market turmoil in recent years.

IV. History of The Military Lending Act and DoD Regulations

The groundswell for action to protect servicemembers from payday lending and other forms of high cost credit began in the late 1990's. When CFA testified at a Senate forum on payday lending held by Senator Joseph Lieberman in late 1999, representatives from the Pentagon attended and requested suggestions for steps to be taken to protect their personnel from predatory lending. CFA met with Department of Defense financial readiness staff, spoke at conferences for military financial counselors, and communicated concerns with military relief society staff. While concern was widespread, an action plan for policy changes did not emerge.

An academic study was published by professors Christopher Peterson and Steven Graves that demonstrated the clustering of payday lenders in proximity to military bases and showed the disproportionate concentration of lenders near bases, making this issue very visible.¹⁸ The maps and analysis were widely quoted, shared with key members of Congress, and became part of the report the Department of Defense later issued to Congress.

When Senator Elizabeth Dole (R-NC) was unable to get substantive reform language included in a defense authorization bill, she succeeded in adding a requirement that the Department of Defense conduct a study of the impact of predatory lending on service members and their families and to deliver that report to Congress. This *Report on Predatory Lending Practices Directed at Members of the Armed Forces and Their Dependents*,¹⁹ issued in 2006, was the subject of a Senate Banking Committee hearing and made the case for an amendment sponsored by Senator Bill Nelson (D-FL) and Senator Jim Talent (R-MO) that was added to the John Warner Defense Authorization Act of 2007. A similar bill had been introduced in the House by Rep. Sam Graves (R-MO).

The Talent-Nelson amendment capped rates at 36 percent APR including fees and other cost, and prohibited loans secured by bank accounts, vehicle titles, and military allotments along with disclosure requirements. It specifically excluded mortgage lending and auto sales financing from coverage. Banks were not excluded by Congress. Talent-Nelson was supported by a large coalition of over seventy military and veterans groups, consumer and community organizations, and the public. A bi-partisan group of Senators urged the conferees to include Talent-Nelson in the Conference Committee version of the defense authorization law that was voted for by both houses of Congress and signed into law by President George W. Bush.

The Secretary of Defense was given authority to write rules to implement what became known as the Military Lending Act, notably to define the specific terms of consumer credit subject to the protections of the law. Following the Administrative Procedures Act, DoD asked for comments

¹⁸ Peterson, Christopher L. and Graves, Steven M., "Predatory Lending and the Military: The Law and Geography of 'Payday' Loans in Military Towns," 66 Ohio St. L.J. 653 (2005).

¹⁹ U.S. Dep't. of Def., Report on Predatory Lending Practices Directed at Members of the Armed Forces and Their Dependents, 51 (2006), www.defenselink.mil/pubs/pdfs/Report_to_Congress_final.pdf

before drafting proposed rules, accepted comments on a proposed set of rules, and issued final rules to take effect October 1, 2007. The law gave DoD a relatively short period of time to develop rules to implement the MLA.

CFA and other groups commented at each opportunity and urged DoD to define covered credit broadly to extend protections to similar forms of high-cost credit.²⁰ The final rules used narrow definitions for payday and car title loans and excluded bank overdraft and direct deposit advance loans. While the Report to Congress described problems caused by military installment lending and rent-to-own retail sales financing, those products were not defined as consumer credit for purposes of the initial set of DoD rules.

Final rules adopted provided definitions of “consumer credit” to be subject to the protections of the law, definitions of “covered borrowers,” and provided a process for identifying covered borrowers.²¹ Advocates felt that the DoD rules too narrowly applied the protections of the Military Lending Act. Payday loans are defined as closed-end loans secured by checks for up to 91 days in duration. Car title loans covered by the law are defined as closed-end loans for up to 181 days secured by the borrower’s vehicle title.

These definitions left out open-end payday and car title loans or loans structured with slightly longer durations to evade the protections. In addition, the rules excluded rent-to-own and installment lending altogether. Comments filed by the American Bar Association as the Department crafted its rules expressed concern that the proposed regulations would dilute the intent of the MLA to provide necessary protections. Specifically, the ABA pointed out that military installment loans and rent-to-own, both included in the DoD Report to Congress, were not defined as “covered credit.”²² Just before the first round of rules was implemented in 2007, the head legal officers for all branches of Service sent a memorandum to the Undersecretary of Defense for Personnel and Readiness, urging expanded coverage of all the products described in the DoD Report to Congress to include rent-to-own and military installment loans.²³ An official at the National Military Family Association noted when DoD rules were issued in 2007 that

²⁰ CFA, Consumer Group Statement on Proposed Department of Defense Predatory Lending Regulations, April 11, 2007, at

http://www.consumerfed.org/elements/www.consumerfed.org/file/finance/Military_Lending_DOD_Proposed_Reg_Comments41107.pdf

See also, CFA, “Consumer Group Comments to the DoD on the Proposed Rulemaking: Limitations on Terms of Consumer Credit Extended to Servicemembers and Dependents,” June 11, 2007, at

http://www.consumerfed.org/elements/www.consumerfed.org/file/finance/DoD_Comments_Final061107.pdf

²¹ 32 CFR Part 232.

²² American Bar Association, Letter to Department of Defense Re: Limitations on Terms of Consumer Credit Extended to Service Members and Dependents (DOD-2006-OS-0216; RIN 0790-AI20), June 11, 2007.

²³ Memorandum for Under Secretary of Defense for Personnel and Readiness, Re: Implementation of Section 670 of the FY 2007 NDAA, signed by Jack L. Rives, Major General, USAF, The Judge Advocate General; Bruce E. MacDonald, Rear Admiral, JAGC, USN, Judge Advocate General of the Navy; Scott C. Black, Major General, USA, The Judge Advocate General; and James C. Walker, Brigadier General, USMC, Staff Judge Advocate to the Commandant of the Marine Corps; August 29, 2007.

instead of clamping down on predatory lending, the Defense Department had chosen the least restrictive measures.²⁴

²⁴ Karen Jowers, "Law restricts family loan options," *Army Times*, September 13, 2007.

V. Impact of MLA on Covered Consumer Credit

A. Finding: MLA Largely Successful in Curbing Abusive Lending as Defined by DOD

To evaluate the success of the Military Lending Act rules in curbing predatory payday, car title, and tax refund loans, CFA conducted visits to four military bases, surveyed federal bank regulators and state credit regulators, and surveyed the availability of covered loans online. We also asked military relief societies if their case loads reflected significant changes in requests for assistance due to the ban on these loans and asked California State University geographer Steven Graves to create maps showing the location of high cost lenders near military bases.

As a result of this fact-finding, **CFA can report that the Military Lending Act has been largely successful in curbing, but not eliminating, predatory lending for products covered by the DoD rules implementing the law.** We discuss our findings for each of the three types of credit defined: refund anticipation loans, storefront and online payday loans, and car title loans.

1. Refund Anticipation Loans

Loans made by banks and sold by tax preparers terminated at the end of the 2012 tax season, due to actions taken by the IRS and bank regulators. In 2008, the first year after the DoD rules defining refund anticipation loans as covered credit took effect, H&R Block sold a tax refund loan that met the 36 percent MAPR interest rate threshold at fewer than 150 offices in the U.S. and in Europe near military bases.²⁵ The Block military refund anticipation loan was not extended after 2008 due to objections by HSBC, Block's main RAL bank partner, to Block's arrangement with another bank to make lower cost RALs to servicemembers.

Data from the IRS evaluated by the Urban Institute demonstrates that the MLA rules were largely effective in halting the sale of tax refund loans to servicemembers. In tax year 2005, the Urban Institute reports that 168,200 servicemembers obtained a refund anticipation loan, with another 221,900 using a refund anticipation check. Their review of IRS data noted a 90 percent drop in the use of RALs after the MLA rules took effect to just 15,700 in tax year 2008. This 90 percent drop is much steeper than the 15 percent overall decline of RAL borrowing among all tax filers.²⁶

As of tax season 2012, only one bank, Republic Bank & Trust, remained in the RAL market and that bank settled an enforcement action by the Federal Deposit Insurance Company with an agreement to exit the RAL business following the 2012 tax season. Republic Bank and Trust offered refund anticipation loans in 2012 at Jackson Hewitt and Liberty Tax Services outlets. As a result of the FDIC settlement, after this year, no banks will remain in the tax refund loan sector.

²⁵ "Law Limits Troops' Options for Tax-Refund Loans," *Army Times*, February 11, 2008.

²⁶ Brett Theodos, Rachel Brash, Jessica F. Compton, Nancy Pindus, C. Eugene Steuerle, "Who Needs Credit at Tax Time and Why: A Look at Refund Anticipation Loans and Refund Anticipation Checks," Urban Institute, November 2010, p. 17-18, available at <http://www.urban.org/uploadedpdf/412304-Credit-at-Tax-Time.pdf>

It is expected that non-bank lenders may partner with financial outlets and some preparers to offer loans during tax season, but CFA has no information that loans meeting the definition of a covered refund anticipation loan are being made to covered service members by non-banks.

Since banks are the lenders making RALs sold via tax-preparers, CFA verified with the federal bank regulators that banks are examined for compliance with the Military Lending Act and DoD MLA rules.

The halt to RALs did not translate to greater use of free tax preparation on military bases. IRS data show that the number of military consumers using Military Volunteers in Tax Assistance (VITA) sites did not increase following implementation of the MLA. In 2007, IRS SPEC data showed 293,023 users of Military VITA sites. That volume declined to 229,419 using Military VITA sites in 2009.²⁷ It could have been expected that the use of free tax preparation on bases would have increased once refund anticipation loans were no longer available to provide a means of payment for tax preparation out of loan proceeds. This drop in the use of free on-base tax preparation may be due to one of several factors. Funding cuts for legal assistance staff may make on-base VITA sites less available. Servicemembers can use free tax preparation and filing options available at the Military OneSource website,²⁸ the IRS Free File program or other free options. A growing number of servicemembers are using refund anticipation checks. The Urban Institute found that some military filers switched from RALs to RACs following the MLA restrictions. A refund anticipation check (RAC) is a direct deposit product to deliver tax refunds from the IRS to the taxpayer and also provides a method of delaying payment of tax preparation fees until the refund arrives. The Urban Institute reported that the number of servicemembers taking a RAC jumped fifty percent in tax year 2008 or 335,400 RACs sold. This increase can be compared to a twenty percent rise in the use of RACs that year by all taxpayers.²⁹

Since servicemembers are required to have an account at a financial institution into which their military pay can be direct deposited, there is no reason to pay extra for direct deposit of tax refunds from the IRS via a RAC. In the case of banked taxpayers, the probable reason for buying a RAC is to defer payment of the tax preparation fee until the refund is received and the fees are deducted before the remaining refund is delivered to the taxpayer. If this is the case for servicemembers, the use of RACs is simply a loan to cover the cost of tax preparation. RACs cost about \$30 in 2012 to “borrow” the typical \$189 tax preparation fee. If computed as a closed-end loan, a RAC costs about 414 percent APR for a two-week loan of the tax prep fee.³⁰

Recommendation: DoD financial education efforts and Military VITA and OneSource outreach should emphasize the savings of free tax return filing and the speed of direct deposit of refunds

²⁷ IRS Nationwide Summary, SPEC Returns Database, 2007, 2008, and 2009, on file with CFA.

²⁸ “H&R Block At Home Online Free Tax Filing Service Ends June 30, 2012,” See www.militaryonesource.mil

²⁹ Urban Institute, *Who Needs Credit at Tax Time and Why: A Look At Refund Anticipation Loans and Refund Anticipation Checks*, November 2010, p. 18.

³⁰ Chi Chi Wu and Jean Ann Fox, “The Party’s Over for Quickie Tax Loans: But Traps Remain for Unwary Taxpayers,” National Consumer Law Center and Consumer Federation of America, February 2012, p. 11.

to servicemembers' accounts. This switch from using RACs to using direct deposit would save servicemembers the cost of unnecessary RACs now deducted from their tax refunds. The 335,400 military RACs taken in 2009 at the \$30 fee charged in 2012 cost servicemembers \$10,062,000 in completely avoidable expenses.

2. Payday loans at stores

Payday loans provided from brick and mortar outlets appear to no longer be widely available to servicemembers, although military borrowers are still encountering this product online and at some stores.

Survey data does not paint a clear picture. A study by FINRA that overlapped the date when MLA protections took effect found that seven percent of surveyed servicemembers reported using payday loans in the prior five years. Further surveying is needed to determine the rate at which covered servicemembers got banned payday loans post October 2007. It is our understanding that the Department of Defense has not replicated the in-depth Defense Manpower Active Duty survey conducted for the 2006 Report to Congress to measure current use of banned products, including payday loans. A fresh look at current use of credit products would aid evaluation of the impact of these protections and point to new and remaining problems to be solved.

Payday lending is now authorized in thirty-three states with the remaining seventeen states and the District of Columbia either prohibiting this form of lending or setting a much lower rate cap than the industry business model uses. As a result of state law and ballot initiative changes, the number of payday loan stores has declined since 2006 and was reported by industry analysts at 19,700 at the end of 2010.³¹

Some states define a "payday-type" loan in a manner that does not fit the DoD MLA rule definition, such as Colorado where loans have a minimum six-month term and are repaid in installments, and Virginia where lenders can make "open-end" payday loans without a license or compliance with the state payday law or DoD regulation. The Colorado regulator reports that lenders do not appear to be taking advantage of the definitional change and are still asking the DoD covered-borrower questions on loan applications. A visit by CFA to a leading payday lender in Tidewater Virginia found that staff claimed to screen out military applicants for open-end loans, but CFA was not able to get a loan application to verify.

CFA's interviews with financial counselors, attorneys, and military charities at four bases across the country consistently found that the MLA protections were largely effective, with a much smaller incidence of problems caused by using payday and car title loans. Financial staff noted that military consumers can still get payday-type loans via the Internet and that other high-cost credit products now caused over-indebtedness problems, including retail credit sales paid via

³¹ David Burtzlaff, "Payday Loan Industry," Stephens Inc., June 6, 2011, p. 5.

allotment from military pay, larger military installment loans, and bank overdraft and direct deposit loans. In talking with legal officers at four bases³², we learned that few if any cases involving payday or car title loans were being heard, with auto financing cases being a priority. One caveat to this generally rosy picture is that there may be a great reluctance by servicemembers to report problems from using banned credit products. One counselor told us that her clients often have a block of unexplained debt, which may reflect problems using covered loans.³³

Relief societies are private charities that provide financial counseling and assistance to servicemembers and their families. The impact of the Military Lending Act can be measured by the before and after statistics on requests for assistance from the Navy Marine Corps Relief Society. The number of active-duty and retired Navy clients involved in payday lending dropped from over 1600 in 2006 to less than 400 in 2008, the year after the protections took effect. The annual assistance provided by NMCRS to those snared by payday loans shrank from more than \$1 million in 2007 to just \$168,000 for most of 2011, with most of this aid going to military retirees not covered by the MLA.³⁴ Air Force Aid counselors at Langley reported few problems with airmen getting covered payday or car title loans and satisfaction with the availability of their Falcon loans as a welcome alternative.

At Fort Leonard Wood, we heard about the continued availability of loans at stores in towns near the base. Counselors knew of cases where prohibited loans were still obtained, either because military spouses falsified applications or because smaller lenders located away from the gates to the base continued to make loans to covered borrowers. One Army Emergency Relief staff person estimated that ten percent of her caseload was due to situations caused by triple-digit payday loan products, based on her contacts with soldiers.

The National Military Families Association reports getting fewer calls from active-duty servicemembers' families due to credit distress caused by payday and similar loans. This nonprofit group also receives calls from veterans with financial problems not impacted by the MLA protections.³⁵

State credit regulators also note a drop in payday lending to servicemembers. Washington's Department of Financial Institutions issues a detailed annual report on payday lending by licensees and includes data on the number of loans made to servicemembers. Washington reported a sharp drop in payday borrowing by the military for 2008, the first full year after the MLA rules applied. Almost 12,000 payday loans were made to military borrowers in

³² MLA Base Case Studies, on file at CFA.

³³ CFA interview with NMCRS staff, Norfolk, VA, September, 2011.

³⁴ Adm. Steve Abbot, "CFA Financial Services Conference," Navy Marine Corp Relief Society, Dec. 2, 2011.

³⁵ CFA conversation with NMFA, November 2, 2011.

Washington in 2006, almost 10,000 in 2007 and 868 in 2008.³⁶ By 2010, Washington payday lenders reported only 131 military borrowers out of a total of 280,587 unique customers.³⁷

CFA surveyed state credit regulators and asked if the payday lenders in their state complied with MLA rules. Regulators responding to the survey noted generally widespread compliance, corrective action taken during examinations, and few enforcement actions taken for violations of the MLA is examined in detail in the Section on enforcement.

3. Payday loans via the Internet

Internet payday loans secured by electronic access to borrowers' bank accounts are also banned by the MLA as defined by DoD. While loans made via the internet are subject to state supervision and consumer protections in the states where borrowers obtain the loans, state regulators have a more difficult task of identifying scofflaw lenders and enforcing state protections. The emerging use of tribal sovereign immunity claims against state enforcement by online lenders undermines the ability of states to police the payday loan market, including state enforcement of MLA protections where permitted.

In 2011, CFA conducted a survey of online lenders but was not able to determine if lenders that asked the DoD covered borrower questions on loan applications stop the loan process if a servicemember clicks "yes" to the question on active-duty military status or whether a different type of loan not defined by the MLA rules is being offered. CFA asked an industry official if applications terminate when a borrower selects the covered borrower tab on the application and was told that the application would be completed so that the lender could offer the borrower a different type of loan. We are not able to verify the extent to which that happens.

CFA's survey of twenty Internet payday loan websites in 2011 found that lenders require electronic access to borrowers' bank accounts. Applications are completed online, with borrowers supplying Social Security numbers, bank account and bank routing numbers, and other personal financial information in online applications. Loans offered range from \$100 to \$1,500, with payment/s due on the borrower's next payday with loan terms ranging from five to thirty days. The typical cost of a \$500 loan is \$125 or 652 percent APR for a two-week loan. Surveyed loan cost ranged from 378 percent to 780 percent APR. The default payment structure for most surveyed sites is to pay the finance charge only, with no reduction in loan principal, for several paydays before paying down a fraction of principal with each payment.³⁸ As a result of this longer payment period, many online loans viewed as "payday loans" have payment terms that exceed the DoD definition of a covered payday loan. As a result, the MLA protections do not apply to what many consumers would view as payday loans.

³⁶ Washington Department of Financial Institutions, "2009 Payday Lending Report," p. 6. www.dfi.wa.gov/cs/pdf/2008-payday-lending-report.pdf.

³⁷ Washington Department of Financial Institutions, "2010 Payday Lending Report," p.3, 6.

³⁸ CFA, "CFA Survey of Online Payday Loan Websites," August 2011, available at <http://www.consumerfed.org/pdfs/CFASurveyInternetPaydayLoanWebsites.pdf>

For this report, CFA surveyed thirty Internet payday loan websites that came up high on Google search results to see if loan applications consistently ask if borrowers are covered servicemembers. We found that twenty of the thirty sites ask for military status on loan applications visible to visitors before personal information is required to be provided. Another five sites are silent on military status, with the remaining five sites' applications not visible beyond the first page. Since CFA's surveyor did not enter personal information on the first page of the application, we were not able to determine if the military status was required later in the application. In the latter case, an applicant would have provided personal financial information before seeing the question about military status.³⁹

An additional risk of going to online lenders is the abusive debt collection activity that often starts soon after consumers apply for loans, whether credit is extended or not. Since 2008, complaints about debt collection harassment from callers with heavy foreign accents have bombarded state Attorneys General offices, Better Business Bureaus, and the FBI. *Army Times* reported about a military family that applied for a loan online but decided not to take it. Soon afterwards, the family started receiving calls from someone who had their Social Security number, address and cell phone number and who threatened that charges would be filed and fines levied because the family had committed an illegal activity by applying for the loan.⁴⁰

Counselors report that servicemembers are still able to obtain high-cost loans via websites. Financial counselors on and off-base at Fort Leonard Wood report that online lending is a chief stressor on the financial situations of service members. We heard the same report at bases in Duval County, Florida and at the Norfolk Naval base. It is not clear if all of those loans are covered by the DoD definition of a payday loan (closed-end, duration of 91 days or less) or if the loans are structured to fall outside the definitions. Lenders that promote loans to the military online have found it easy to restructure their "payday loans" as open-end credit to evade the definition of "covered credit" in the DoD rules.

Military Financial (www.militaryfinancial.com) is an Internet-only military lender with a Wilmington, Delaware address, also operated under the name International Cash Advance located in Tortola, British Virgin Islands.⁴¹ It will loan up to 40 percent of a servicemember's take home pay. Loans are structured as an "open-end" Line of Credit. Although loan costs are not disclosed on the website, CFA has on file a 2012 Line of Credit Activity Statement that quotes 584.68 percent APR.⁴² A Military Financial Line of Credit Activity Statement from 2010 itemizes two fees charged in addition to the finance charge: A \$20 Credit Access Fee and a \$15 Transfer Fee.⁴³ Military Financial

³⁹ CFA survey of online payday loan applications, March 19, 2012, on file.

⁴⁰ Karen Jowers, "Consumer Watch: Need a loan? Be wary of 'fast cash' Web lenders," *Army Times*, January 13, 2011.

⁴¹ Military Financial "Welcome Back" communication to Virginia consumer, 12/7/2010,

⁴² Military Financial "Line of Credit Activity Statement, February 10, 2012, on file with CFA.

⁴³ Military Financial Line of Credit Activity Statement, June 2010, on file with CFA.

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.⁴⁴

A sailor stationed at Parris Island Marine Corps Recruit Depot became indebted to Military Financial when his wife took out a loan online. The loan cost 584.68 percent APR. For a one-month \$415 extension of credit, the sailor was billed \$93.06 finance charge for a total required payment of \$170.92. The lender warned that it would automatically debit his bank account for the \$170.92 if payment was not received on the monthly due date. As a result of the extremely high interest, the servicemember turned to another, slightly less expensive military installment lender to pay off the original line of credit. The new loan stated an APR of 80 percent for a \$1,500 loan with a \$731.03 finance charge (loan fee \$600 and interest \$131.03) for a total \$2,231.03 in payments.⁴⁵

Since DoD relies on state credit regulators to ensure compliance with the Military Lending Act, the industry trend to a business model that evades enforcement of state laws may undermine progress made to date. A growing number of online lenders are claiming affiliations with Native American tribes to claim tribal sovereign immunity from enforcement of state laws. States including California, Colorado, West Virginia, Missouri, and Maryland have litigated their ability to enforce state payday loan and installment loan laws with online lenders that claim to be immune due to various connections to tribes. To the extent this latest tactic to evade state usury ceilings and rate caps succeeds, the Department of Defense will not be able to rely on state regulators to police the payday loan market. Since the Consumer Financial Protection Bureau does not have direct authority to enforce the Military Lending Act or to set a national usury ceiling, the enforcement options involving non-bank lenders subject to the MLA will be limited.

4. Car Title Loans

The 2006 DoD Report to Congress included car title lending in the list of predatory lending products that cause morale and stress problems for the military. Loans secured by title to the borrower's vehicle typically cost 300 percent APR, are structured as single payment one-month loans, and result in repossession of the borrower's vehicle if the loan is not paid in full or renewed each month.

Loans secured by title to a vehicle owned by the borrower are authorized in less than half the states. In two states, Alabama and Georgia, title lending operates under the state pawn law, resulting in no state-level supervision of title lenders for compliance with the MLA. Former Georgia Governor Roy Barnes sued a title lender for violation of the Military Lending Act in late

⁴⁴ <https://www.militaryfinancial.com/Faq.aspx> visited 9/20/11

⁴⁵ Case File from military charity on file with CFA.

2011.⁴⁶ Although that litigation is far from completed, the courts have rejected a claim by the lender that “pawn” title loans are not subject to the Military Lending Act.

Under some state laws, the car title loan product is not defined to match the DoD definition for a covered car title loan. For example, Arizona’s law is interpreted by state regulators as not requiring that the loan be secured by the title to a paid-for vehicle. Since these loans costing over 200 percent APR are made to anyone with a vehicle registration, it does not come under the MLA definition which requires a title. A bill to require Arizona title lenders to comply with the MLA and DoD rules was rejected by the Arizona legislature.

Open-end car title loans are not subject to the MLA as defined by DoD. Title lenders in Kansas structure loans as open-ended to charge higher rates than the small loan laws permit for licensed lenders in that state. Up until the fall of 2010, car title loans in Virginia were claimed to be open-end “motor vehicle equity lines of credit” as lenders avoided the Commonwealth’s 36 percent APR cap on closed-end small loans. For example, a “Motor Vehicle Equity Line of Credit” from a Virginia lender loaned \$800 at 365 percent APR based on title to a 1998 Nissan Maxima. The minimum monthly payment was mostly interest plus five percent of the loan principal.⁴⁷ Since the Virginia open-end car title loans were not subject to the DoD definition of a covered car title loan, servicemembers stationed in Virginia were not protected.

Under legislation enacted in 2010,⁴⁸ Virginia law now authorizes car title lending costing up to 264 percent APR and permits loan terms up to one year while the DoD definition of a covered car title loan only applies to loans with a term of 181 days or less. A twelve-month \$700 car title loan at the maximum rates permitted in Virginia costs \$2,548 with monthly payments of \$212. Fortunately the Virginia legislature prohibited car title loans to servicemembers.⁴⁹ This is not the case in Texas. The Texas title loan law that took effect in 2012 requires title lenders to comply with MLA but does not require that loans be structured as defined by DoD to be subject to the MLA protections.

Financial counselors and consumer attorneys have reported to CFA that title loans are being made to servicemembers. Examples include:

- The spouse of a servicemember in Virginia obtained a car title loan for \$1200, payable in twelve monthly installments totaling \$3,248.40. The finance charge was \$2,054.22 and the quoted APR was 240.03%. A \$6 lien fee was added to the loan proceeds. The loan was secured by the title to her vehicle and the contract included a mandatory arbitration clause and prohibited participation in a class action lawsuit. Under the DoD definition of a covered car title loan, this loan is not prohibited, although the Virginia law bans car title

⁴⁶ Jason M. Cox vs. Community Loans of America, Inc., Alabama Title Loans, Inc., Civil Action No. 4:11-CV-177-CDL, United States District Court for the Middle District of Georgia, filed November 11, 2011.

⁴⁷ Contract for Motor Vehicle Equity Line of Credit Agreement, dated May 7, 2010, on file with CFA.

⁴⁸ Chap. 21 of Title 6.2 Code of Virginia

⁴⁹ Virginia Poverty Law Center fact sheet “New Law Took Effect October 1, 2010,” on file with CFA.

lending to the military. It is not apparent from the contract on file with CFA whether the lender was told the military status of the borrower.⁵⁰

- Jason Cox is an E-6 Staff Sergeant in the Army and Purple Heart recipient with five children. He is stationed at Ft. Benning, Georgia, and has had two deployments to Iraq. He needed money for a family emergency and went to a title lender to repay a debt to a family member. The one-month car title loan from Alabama Title Loans, Inc. of \$3,000 cost 146 percent APR, secured by the title to a 2002 Dodge Durango. One monthly contract shows a \$360 finance charge on the \$3,000 loan for a total due of \$3,360.⁵¹ Cox paid to renew the loan for over a year but lost the vehicle to repossession in August 2011, losing both the vehicle and all the money paid to avoid repossession. Since title loans are made under the Georgia pawn law, lenders are not required to return any residual value after a repossessed vehicle is sold. The lender made repeated collection calls while the soldier was at work and demanded the use of arbitration, claiming that the Military Lending Act does not apply to the transactions. Mr. Cox has filed a class action lawsuit against the title lender, claiming that the loan violated the Military Lending Act.⁵²
- An E-8 Master Sergeant, stationed at Ft. Benning, GA, has been paying on a car title loan his wife obtained while he was deployed to Iraq to pay for bills and food. The loan from Georgia Auto Pawn, Inc. was for \$618, with a finance charge of \$77.25, or 152.08 percent APR. The one-month title loan was secured by a 1994 Chevrolet Camaro. After a year of payments, the loan principal has barely been reduced and repossession has been threatened.⁵³
- An E-5 Sergeant in the Marines, stationed at NSB, Kings Bay Georgia, got a title loan from Georgia Auto Pawn, Inc. in late 2010. One loan for \$1,515 has a finance charge of \$189.37 for an APR of 152.08 percent. The loan was due in full in one month and was secured by a 1999 Jeep Grand Cherokee. He has extended the loan month to month for almost a year.⁵⁴

In some cases, servicemembers are getting car title loans that fall outside the definitions of covered loans.

- SSGT who has been an active duty Marine for 18 years obtained a car title loan in South Carolina in 2011 to pay debts associated with a pending divorce. He presented his

⁵⁰ Contract for Motor Vehicle Title Loan, dated June 24, 2011, on file with CFA.

⁵¹ Alabama Title Loans, Inc., contract, dated July 2, 2010. Maturity date August 1, 2010. Contract includes an arbitration clause.

⁵² Jason M. Cox vs. Community Loans of America, Inc., Alabama Title Loans, Inc., Civil Action No. 4:11-CV-177-CDL, United States District Court for the Middle District of Georgia, filed November 11, 2011.

⁵³ Electronic communication from soldier's attorney, January 18, 2012. Contract on file with CFA.

⁵⁴ Electronic communication from Marine's attorney, January 18, 2010. Contract on file with CFA.

military ID when applying and got a Smart Choice Title Loan of \$1,615, including the \$15 lien fee, secured by a 1998 Ford Expedition. The finance charge is \$15,613.48 and the payment schedule calls for 32 monthly payments totaling \$17,228.48. The APR on the contract is 400 percent. The Marine's vehicle was repossessed because he could not afford another \$300 payment. Because the car title loan term exceeds 181 days, it is not covered by the DoD Military Lending Act protections. The contract includes a mandatory arbitration clause.⁵⁵

- A servicemember in San Diego got a car title loan from Check Cashiers of Southern California, Inc., dba USA Checks Cashier as brokered by 800LoanMart. The loan was for \$2,604 which included a \$19 DMV Lien Fee and a \$75 Prepaid Loan Fee for a loan just over the threshold for the small loan rate cap. The borrower was required to surrender his title to 1999 Ford Expedition and a copy of the keys. The borrower received \$2,510, but was obligated to pay \$4,426.68 in finance charges for a 24-month loan at 124.7 percent APR. The contract includes an arbitration clause and requires the borrower to waive rights to pursue or participate in a class action lawsuit. In California, title loans are typically for over \$2,500 to evade the small loan rate cap that applies to loans of \$2,500 or less, resulting in larger than typical and longer-term loans.

Title loan companies solicit business on the Internet via lender and marketing websites that either make loans directly or feed completed applications to other lenders. A CFA review of online title 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 applications where the lender may ask about military status at a later point in the application. For those sites that stated a maximum loan term, most exceeded the 181-day term used in the DoD rules for covered car title lending.

Recommendation: CFA recommends that CFPB and state regulators work with DoD to ensure all car title lenders comply with MLA rules and do not evade those rules by exploiting loopholes in existing MLA definitions.

Recommendation: The MLA rule definitions for covered car title loans should be revised to remove the definitional loopholes, either by Congress or through DoD rule-making. The MLA protections should extend to any non-purchase money loan secured by the title to the borrower's vehicle regardless of loan term or dollar amount or whether the loan is structured as open or closed-ended credit.

⁵⁵ Smart Choice Title Loans contract, dated June 24, 2011, on file with CFA. Electronic communication from borrower's attorney, on file with CFA.

VI. Maps Illustrate Impact of Military Lending Act at Selected Bases

The Department of Defense Report to Congress in 2006 included maps of selected bases to illustrate the concentration of payday and other high-cost lenders around military bases and noted that the maps provided “clear evidence that certain portions of the lending industry are focused on the military market.”⁵⁶ The maps were prepared by Professor Steven M. Graves, California State University, Northridge. As reported in 2006, communities with military bases ranked among the most heavily targeted communities for lenders in their respective states. For example, there were four times as many payday lenders per capita around McChord Air Force Base and the Army’s Fort Lewis compared to residents living in the rest of Washington state.

To evaluate the impact of the Military Lending Act which banned payday and car title lending starting in 2007, CFA requested Professor Graves to update maps to illustrate the current population of payday, car title, and military installment lenders near bases. The results show that the new federal protections resulted in a sharp drop in high-cost lenders near bases in those states that also have rate caps for small lenders, such as California. The maps in states where high-cost lenders can legally tweak their products to evade the DoD definitions of covered credit show little or no improvement, as in Texas. Results are harder to measure in locales where bases are part of large urban communities, such as Hampton Roads, Virginia, and Duval County, Florida.

The most dramatic change following the 2007 implementation of the Military Lending Act occurred outside the gates to Camp Pendleton in California, where local zoning ordinances were adopted to restrict the proliferation of payday lenders and California enacted legislation authorizing state regulators to enforce the MLA.

A. Oceanside, California Case Study

Reform of high-cost lending in Oceanside combined the impact of federal law, state authority to enforce federal Military Lending Act protections, and local government action to curb the proliferation of payday lenders through a zoning ordinance.

Oceanside, California is a coastal community of 183,000 that boasts scenic beaches, historic architecture, and “year round perfect weather.”⁵⁷ The city is located in northern San Diego County, 35 miles from San Diego, 83 miles from Los Angeles, and directly adjacent to Marine Corps Base Camp Pendleton, one of the busiest military bases in the United States.⁵⁸ Camp Pendleton is home to more than 42,000 active duty military personnel and 38,000 military family members, many of whom reside off-base in Oceanside.⁵⁹ In addition, over 23,000 reservists from all branches of the military train at Camp Pendleton each year, and 77,000 retired military

⁵⁶ Department of Defense, “Report on Predatory Lending Practices Directed at members of the Armed Forces and Their Dependents,” August 9, 2006, p. 10.

⁵⁷ “WELCOME TO OUR CITY” CITY OF OCEANSIDE, accessed October 5, 2011. <http://www.ci.oceanside.ca.us/>.

⁵⁸ “OCEANSIDE AT A GLANCE.” CITY OF OCEANSIDE, accessed October 5, 2011. <http://www.ci.oceanside.ca.us/about/city.asp>.

⁵⁹ “MARINE CORPS BASE CAMP PENDLETON,” UNITED STATES MARINE CORPS, accessed October 5, 2011. <http://www.marines.mil/unit/basecamp Pendleton/Pages/Information/AboutTheBase/Population.aspx>

personnel reside within a 50-mile radius of the base.⁶⁰ For over 60 years, Camp Pendleton has been the largest employer in north San Diego County.⁶¹

Such a large, concentrated population drawing military paychecks makes Oceanside a tempting location for payday lenders to set up shop.⁶² In 2004, Oceanside was home to an unusually high concentration of payday lenders for a city of its size.⁶³ Military leaders were aware of the dangers posed by these payday lenders to the financial health and operational readiness of soldiers, sailors, and marines, and were making efforts to improve the financial awareness of service members.⁶⁴ In Oceanside, they took more direct steps to address the particular problem of payday lenders. In January 2007, Major General Michael Lehnert, the commanding General of Marine Corps Installations West, addressed the Oceanside City Council on the dangers of predatory lending to troops and requested help limiting the number of payday lenders operating in the vicinity of Camp Pendleton.⁶⁵

In response to General Lehnert's concerns, the Oceanside City Council began to consider adopting changes to the Oceanside Zoning Ordinance that would make it more difficult for payday lenders to open new storefronts in the city. In January 2007, the zoning ordinance subjected payday lenders to the same restrictions as banks and savings and loan establishments. Payday lending storefronts could be opened in almost any commercial zone without being subject to any kind of discretionary land use review.⁶⁶ Research conducted by the city council staff indicated that payday lenders shared many of the characteristics of other businesses that were classified as regulated uses by the Oceanside Zoning Ordinance.⁶⁷ Specifically, the city

⁶⁰ *Id.*

⁶¹ *Id.*

⁶² Although the idea that payday lenders "target" members of the military has long been the subject of controversy, a 2004 empirical study of 20 states, 1516 counties, 13,253 ZIP codes, almost 15,000 payday lenders, and 109 military bases concluded unambiguously, "We have no doubt that the military is a target demographic for the payday lending industry. Around each of the bases we analyzed, the greatest concentration of payday lenders anywhere in the county was within a few miles of the military base. Payday lenders crowd around the gates of military bases like bears on a trout stream." Stephen M. Graves and Christopher L. Peterson, *Predatory Lending and the Military: The Law and Geography of 'Payday' Loans in Military Towns*, 66 OHIO STATE LAW JOURNAL 653, 824(2005).

⁶³ Graves and Peterson's empirical study found that the ZIP code at Camp Pendleton's southern gate (92054) had 22 payday lenders in 2005, five more than any of the other 1661 ZIP codes in the state of California. The city of Oceanside as a whole had 17 more payday lenders than what would be expected given the size of its population. By comparison, the neighboring ZIP codes of Carlsbad, California (92008 and 92009) had 3,000 more people and only two payday lenders. In 2005, there were six more payday lenders than banks in Oceanside. *Id.*

⁶⁴ See generally DEPT. OF DEFENSE, REPORT ON PREDATORY LENDING PRACTICES DIRECTED AT MEMBERS OF THE ARMED FORCES AND THEIR DEPENDENTS (2006). While noting improvements in the ability of service members to manage their finances, attributed to increased education efforts, the report also cautioned: "Regardless of the efforts of the Military Services to educate Service members and provide them effective alternatives, problems associated with poor financial management will be a source of considerable collateral damage unless Service members select more positive interventions to relieve their financial burdens. For example, a recent study within the Navy showed that the number of security revocations and denials for financial reasons has increased from 212 in fiscal year (FY) 2002, to 1,999 in FY 2005 (representing 80 percent of all revocations and denials for that year)."

⁶⁵ Martha Kellogg, *Oceanside Restricts New Payday Loan Stores*, NORTH COUNTY TIMES, Sept. 20 2007, available at http://www.nctimes.com/news/local/article_5aef6d68-ea97-530e-b070-dd7c01632a69.html.

⁶⁶ CITY OF OCEANSIDE, STAFF REPORT ON LOCAL COSTAL PROGRAM AMENDMENT (LCPA-2-07) AND ZONING AMENDMENT (ZA-4-07) (2007) at 1.

⁶⁷ "Regulated uses" are defined to include activities that typically have a negative impact on quality of life when concentrated in a single geographic area. The Oceanside Zoning ordinance defines regulated uses to include *inter*

council staff found that the presence of payday lenders in a given area had a negative aesthetic impact and was correlated with increased crime rates.⁶⁸ Based on these findings, the city council staff recommended that the city's Zoning Ordinance be modified to define payday lending as a separate business category and to classify it as a regulated use.⁶⁹ In addition, the modifications limited new payday lending establishments to specified commercial zones and required them to obtain a conditional use permit from the city council.⁷⁰

In September 2007, Oceanside's City Council unanimously voted to adopt Resolution No. 07-R0621-1, which modified the Oceanside Zoning Ordinance according to the staff recommendations.⁷¹ The modifications only affected new or pending applications for licensure of a payday lending businesses, but they created significant hurdles to establishing these businesses. By subjecting payday lenders to the conditional use permit process, the modifications ensured that all new applications for payday lending licenses would be subject to a case by case, discretionary review evaluating their compatibility with surrounding land uses.⁷² As a regulated use business, new payday lenders could no longer open within 1,000 feet of any other regulated use business.⁷³ In addition, new payday lenders could not be located within 500 feet of any residential district, school, park, church, or child-care facility.⁷⁴

The city council's modifications to the Oceanside Zoning Ordinance produced mixed public reactions. Military representatives present when the changes were adopted were supportive, and one council member expressed regret that the changes adopted did not go further to eliminate

alia: arcades and gaming centers, tobacco and drug paraphernalia establishments, liquor stores, billiard and pool halls, massage parlors, and adult entertainment businesses. See OCEANSIDE, CAL., ZONING ORDINANCE, art. 36 (2011).

⁶⁸ "Many of the [payday lending] businesses maintain extensive and nontraditional hours of operation, maximize signage and/or other means of advertising causing aesthetic impacts and are subject to code enforcement compliance actions. Crime statistics within 1/5 mile of existing non-traditional lending facilities indicate a high percentage of crime incidents within the immediate area of such establishments; however conclusions specifically tying the criminal activities to the payday loan uses cannot be drawn due to the proximity of other potential crime sources/causes." CITY OF OCEANSIDE, STAFF REPORT ON LOCAL COSTAL PROGRAM AMENDMENT (LCPA-2-07) AND ZONING AMENDMENT (ZA-4-07) (2007) at 2-3.

⁶⁹ The proposal modified Article 4 of the Oceanside Zoning Ordinance to include a new use classification defining payday lenders as: "A person or persons that for compensation, engages in whole or in part in the business of lending limited amounts of funds for a short term against the borrower's future paychecks." Payday lenders were then added to the list of restricted uses subject to the special, location-based restrictions detailed in Article 36. See OCEANSIDE, CAL., ZONING ORDINANCE, arts. 4, 36 (2011).

⁷⁰ Conditional Use Permits are a type of discretionary permit required for certain businesses under the Oceanside Zoning Ordinance. Conditional Use Permits are granted by the City Planner, Planning Commission, or the City Council after individual consideration of a proposed business to ensure that it will be designed, located, and operated in a manner that is compatible with surrounding area. "PERMIT PLANNING" CITY OF OCEANSIDE, accessed October 12, 2011. <http://www.ci.oceanside.ca.us/faq/categoryqna.asp?id=35#574>. The City Council Staff Report proposed modifying Article 11 of the Oceanside Zoning Ordinance to subject new applications for licenses to operate a payday lending business to the conditional use permitting process and to limit them to General Commercial and Community Commercial zones. CITY OF OCEANSIDE, STAFF REPORT ON LOCAL COSTAL PROGRAM AMENDMENT (LCPA-2-07) AND ZONING AMENDMENT (ZA-4-07) (2007) at 2.

⁷¹ CITY OF OCEANSIDE, OCEANSIDE CITY COUNCIL MEETING AGENDA FOR SEPTEMBER 17, 2007 at 6.

⁷² CITY OF OCEANSIDE, STAFF REPORT ON LOCAL COSTAL PROGRAM AMENDMENT (LCPA-2-07) AND ZONING AMENDMENT (ZA-4-07) (2007) at 3.

⁷³ OCEANSIDE, CAL., ZONING ORDINANCE, art. 36 (2011).

⁷⁴ *Id.*

existing payday lenders.⁷⁵ Other council members expressed concern that the ordinance could not address the fundamental problems that contribute to high demand for payday lenders such as a lack of low-cost credit alternatives for low income individuals.⁷⁶ An opponent of the adopted modifications expressed his belief that the changes to the ordinance were unnecessary, given restrictions placed on payday lending to members of the military by Department of Defense.⁷⁷ Those restrictions were the result of the 2007 Military Lending Act, which capped interests rates charged to members of the military on certain types of loans, including payday loans, at 36%.⁷⁸ While praising the new protections granted by the Military Lending Act, many consumer activists felt that they did not go far enough in protecting service members against the full range of predatory lending practices, thus necessitating additional protections on a state and local scale such as the zoning ordinance modifications in Oceanside.⁷⁹

Five years later, it appears that supporters of the ordinance modifications have achieved their goal, a significant reduction in the number of payday lenders operating in Oceanside. The zoning ordinance only impacted new payday loan outlets, not the existing stores, while the federal Military Lending Act banned payday loans for active-duty servicemembers and their dependents. The ordinance modifications were adopted at almost the exact same time that the Military Lending Act restrictions went into effect. The number of payday lenders operating in Oceanside began to decrease significantly after the two changes went into effect in October 2007.⁸⁰ In 2004, Oceanside's 92054 ZIP Code, which is closest to the southern gate of Camp Pendleton, was home to 22 payday lenders.⁸¹ Today that number has been reduced to 6, a

⁷⁵ Martha Kellogg, *Oceanside Restricts New Payday Loan Stores*, NORTH COUNTY TIMES, Sept. 20 2007, available at http://www.nctimes.com/news/local/article_5aef6d68-ea97-530e-b070-dd7c01632a69.html.

⁷⁶ "Councilman Jack Feller laid much of the blame for the proliferation of [payday lenders] at the feet of banks and credit unions, which he said are not meeting the small lending needs of the community. 'They need to get their act together if they're really serious about helping the community in the future,' he said." Councilman Jerry Kern commented, "I'm going to support this, but I have concerns. We're trying to regulate behavior." *Id.*

⁷⁷ "The one speaker in support of payday businesses was Charles Piedmont, who owns two Cash A Check stores in Oceanside. 'This ordinance is categorically wrong,' he told the council, saying that a new law prohibiting such lending by members of the military goes into effect Oct. 1 anyway. 'I really don't understand what we're trying to accomplish here.'" *Id.*

⁷⁸ In 2006, Congress authorized the Department of Defense to issue regulations to protect troops from predatory lending traps. John Warner Defense Authorization Act for Fiscal Year 2007, Pub. L. No. 109-364, 120 Stat. 2083 (2006). The DOD subsequently issued regulations that capped interest rates for defined categories of payday, auto-title, and tax-refund anticipation loans made to members of the military. Limitations on Terms of Consumer Credit Extended to Service Members, 32 C.F.R. pt. 232 (2006). Both the enabling legislation and the regulations are often collectively referred to as the Military Lending Act. The regulations went into effect on October 1, 2007.

⁷⁹ See generally Press Release, Center for Responsible Lending, Consumer Federation of America, and National Consumer Law Center, Military Lending Act to Take Effect October 1 (Sept. 27, 2007).

⁸⁰ "Among the ZIP codes in California adjacent to very large military installations, the drop in the number of payday lenders appears to be very significant. For example, Oceanside, California, home to Camp Pendleton, has seen one of the more precipitous changes in the number of payday lending shops. In Oceanside's 92054 ZIP code there were 22 payday lenders licensed in 2004; now there are only 13, representing a 40% decrease." Center for Responsible Lending, Consumer Federation of America, Consumer's Union, National Association of Consumer Advocates, and National Consumer Law Center, Comments on Implementation of Terms of Consumer Credit Extended to Service Members and Dependents 72 Federal Register 73336-7 (Feb. 25, 2008).

⁸¹ Steven M. Graves and Christopher L. Peterson, *Predatory Lending and the Military: The Law and Geography of 'Payday' Loans in Military Towns*, 66 OHIO STATE LAW JOURNAL 653, 824(2005) at 722.

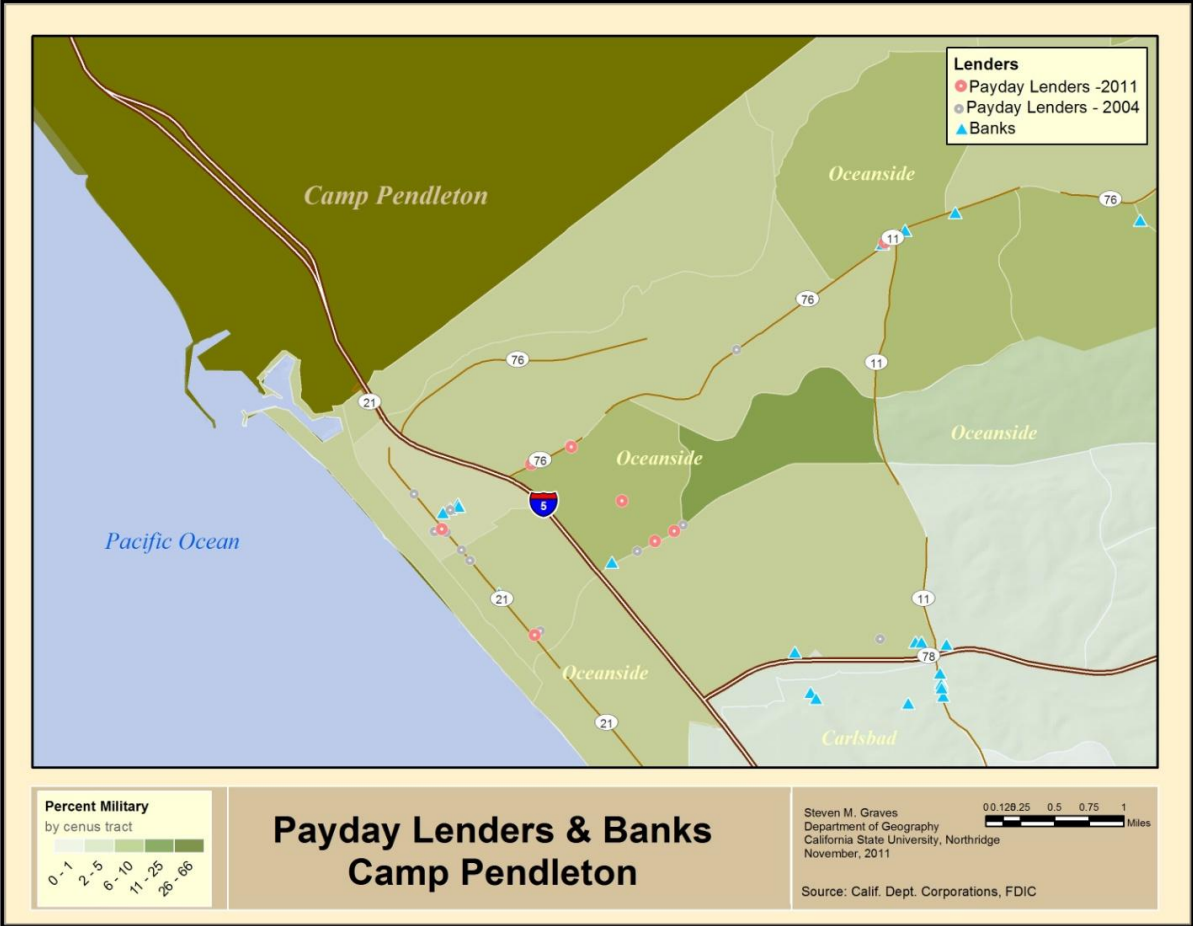
reduction of 72%, and two of the remaining payday lenders are subject to pending legal action.⁸² Overall, the number of payday lenders operating in Oceanside has declined from 28 to 11, a reduction of over 60%.⁸³ To put those declines in context, Modesto and Anaheim are two other cities in California that each had 28 payday lenders in 2004, but no comparable proximity to a military base.⁸⁴ Today, Modesto has 26 payday lenders actively licensed, a reduction of only 12%, and Anaheim is still home to 28 active payday lenders.⁸⁵

⁸² “FINANCIAL SERVICES DIVISION LICENSEE ADDRESS LISTING,” CALIFORNIA DEPT. OF CORPORATIONS, accessed October 13, 2011.
<http://www.corp.ca.gov/FSD/licensees/default.asp?flag=1&srctyp=contains&licstatus=active&busname=&id=&lictype=Deferred+Deposit+Originator&city=&state=CA&zip=92054>.

⁸³ California Department of Justice, Office of the Attorney General, California Deferred Deposit Lender List, October, 21 2003 (on file with authors) (provided on floppy disk to authors by request). The “before” number came from the DOJ computer disk of the information in 2003 provided to Dr. Graves. The “after” number comes from FINANCIAL SERVICES DIVISION LICENSEE ADDRESS LISTING,” CALIFORNIA DEPT. OF CORPORATIONS, accessed October 13, 2011.
<http://www.corp.ca.gov/FSD/licensees/default.asp?flag=1&srctyp=contains&licstatus=active&busname=&id=&lictype=Deferred+Deposit+Originator&city=Oceanside&state=CA&zip=>.

⁸⁴ California DOJ floppy disk (October 21, 2003) see above.

⁸⁵ FINANCIAL SERVICES DIVISION LICENSEE ADDRESS LISTING,” CALIFORNIA DEPT. OF CORPORATIONS, accessed October 13, 2011.
<http://www.corp.ca.gov/fsd/licensees/default.asp?flag=1&srctyp=contains&licstatus=active&busname=&id=&lictype=Deferred+Deposit+Originator&city=Modesto&state=Ca&zip=> (Modesto), and
<http://www.corp.ca.gov/fsd/licensees/default.asp?flag=1&srctyp=contains&licstatus=active&busname=&id=&lictype=Deferred+Deposit+Originator&city=anaheim&state=Ca&zip=> (Anaheim).



B. Fort Hood, Texas

Fort Hood Army base near Killeen, has been a favorite location of payday lenders in Texas. Payday and car title lenders have not been licensed as credit providers in Texas, operating as credit services organization businesses. Lenders have used a variety of guises to avoid compliance with the Texas small loan act, including claiming that loans are catalog sales with cash back. The lack of regulatory structure in Texas makes cataloging the type and density of predatory lenders difficult around Fort Hood. Several data sources were consulted, including the roster of businesses operating as credit service businesses and various directory listings (Google directory listings). Our analysis shows that predatory lending near Fort Hood has not been curtailed since 2007.⁸⁶

The number of traditional payday lenders has not changed in the Fort Hood region since enactment of the MLA. We estimate there were 22 total payday lenders in the ZIP Codes adjacent to Fort Hood in 2005.⁸⁷ Since that time, Copperas Cove, one of the two towns serving Fort Hood has added a “catalog lender” and a car title lender to its roster of high-cost small loan options. In Killeen’s 76541 ZIP Code (which borders the eastern gate) the number of payday lenders seems to have dropped by 3 since 2005, and two car title lenders have disappeared, but it has gained a couple of extra military installment lenders and a catalog lender. Similar changes have occurred in the other nearby ZIP Codes.

Cash in Advance has only one store, but most of the other operations have expanded. For example, Ace Cash Express and Check ‘N Go have added one store apiece. The Cash Store has opened two additional storefronts. The 2011 mapping project included three additional payday lenders that also offer car title loans. It is not clear if they were in operation in 2005. A possible explanation for the continued concentration of high-cost loan outlets near Fort Hood is that lenders offer several loan products, including loans that do not fit the definition of a covered payday or car title loan under the DoD regulations. For example, the Cash Store offers a 14-day cash advance at 533.11% APR interest which, if structured as a closed-end loan, is prohibited for active-duty servicemembers. Cash Store also makes 140-day installment loans. For the same \$500 loan, a borrower would pay 611.72% APR for a loan not covered by the DoD definition of a payday loan.⁸⁸ Lenders not covered by DoD definitions of covered credit are in business near Fort Hood include four military installment lenders.

Servicemembers stationed at Fort Hood continue to have financial stresses. According to news reports, the number of soldiers and their dependents, as well as retirees, received emergency loans from Army relief that went from less than two thousand in 2004 to a peak of 8,486 in 2007 at the height of the Iraq war to 5,776 in 2011. In addition 1,362 families were assisted at the Fort Hood food pantry in 2011, with a total of nearly 5,000 assisted since the pantry opened in 2008. An American-Statesman in-depth report on the financial struggles of soldiers at Fort Hood noted

⁸⁶ Google Maps, category search: payday loans. <http://maps.google.com/maps> (last accessed July 14, 2011). Google Maps uses information from sources such as InfoUSA, but also collects data from businesses directly and subcontracts “ground truthing” operations to ensure high quality data.

⁸⁷ InfoUSA, ReferenceUSA, available at <http://www.ReferenceUSA.com> (accessed October 17, 2005).

⁸⁸ Fee schedule, “Texas Cash Advance & Installment Loans,” www.cashstore.com, on file with CFA.

that use of food stamps at on-post commissaries had increased from \$285,000 in 2001 to \$1.4 million in 2011.⁸⁹

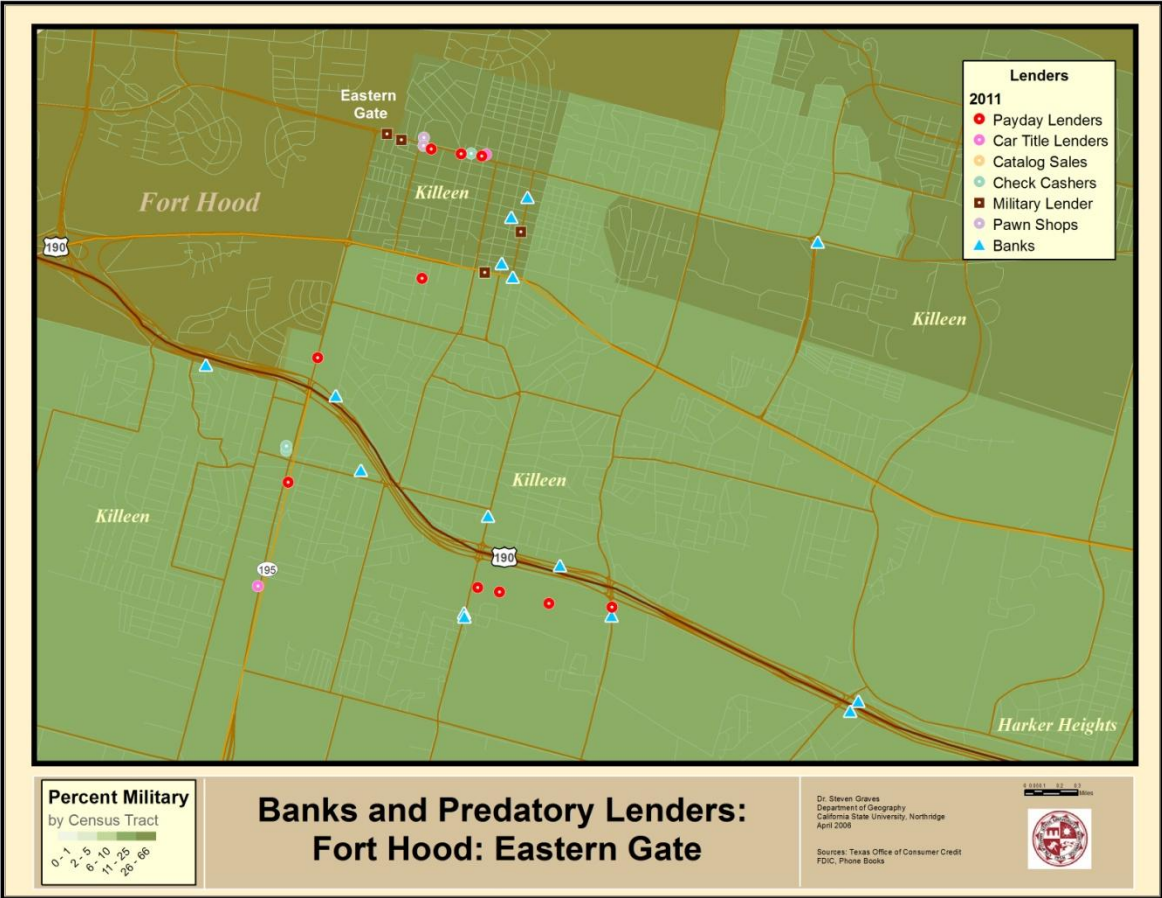
Another obvious reason that we do not see the scale of reduction in predatory lending near Fort Hood as is the case near other military bases is that Texas has had little of the regulatory structure one sees in other states. Texas has not regulated high cost lending as other states do, leaving essentially no apparatus to enforce the few regulations on this industry that do exist in Texas. The lack of enforcement, licensing or supervision apparatus may have precluded Texas officials from enforcing the provisions of the MLA. Military families in Texas continue to be vulnerable.

New legislation that took effect in 2012 authorizes the Texas Office of Consumer Credit Commissioner to enforce the DoD MLA rules. However, that legislation does not require payday and car title loans to comport with the definitions of covered credit that would make the MLA protections restrain loans made to servicemembers in Texas.⁹⁰ This may be one reason that financial counselors report “a large number of soldiers trying to pay off loans with astronomical interest rates, provided by the legion of payday lenders and auto title lenders surrounding the post. ‘When you look at their resources, they are spending so much on the loans they don’t have enough to pay for utilities, gas or rent,’ ...”⁹¹

⁸⁹ Jeremy Schwartz, “Fort Hood soldiers fight to make ends meet,” American-Statesman, February 25, 2012.

⁹⁰ Texas H.B. 2594, effective 2012, section 393.625, Finance Code, requires that payday and car title loans provided through credit services organizations must comply with 10 U.S.C. Section 987 and any regulations adopted under that law, to the extent applicable.

⁹¹ Schwartz, American-Statesman.



C. Duval County, Florida

Florida is another state that continues to permit payday lending within its borders. Few regulatory changes have occurred there since 2006, though it should be noted that the public disclosure of which establishments function as “deferred deposit lenders” (payday lenders) has been significantly diminished, making data collection and comparison to earlier data sets difficult.⁹² This unfortunate trend has made it difficult to measure the effect of the MLA on predatory lending to military families in Florida.

Home to Jacksonville Naval Air Station and Mayport Naval Base, Duval County has been a hotbed of predatory lending for a number of years. In 2004, Duval County ranked first among Florida’s counties in terms of numbers and density of payday lending.⁹³ At the ZIP Code level in 2004, the 32210 ZIP Code, which is adjacent to the Jacksonville Naval Air Station, ranked first in the entire state in terms of the total number of payday lenders with eleven outlets. Unlike many of the other base-adjacent ZIP Codes in this study, there has been a slight increase in payday lending activity near Jacksonville NAS. In 2011, there were twelve payday lenders in the 32210 ZIP Code.⁹⁴ It should be noted that five payday lenders in the 32210 ZIP Code have either let their licenses expire or were terminated by the regulatory officials, according to the list of licensed “Money Transmitters” (which includes payday lenders) downloaded from the State of Florida.

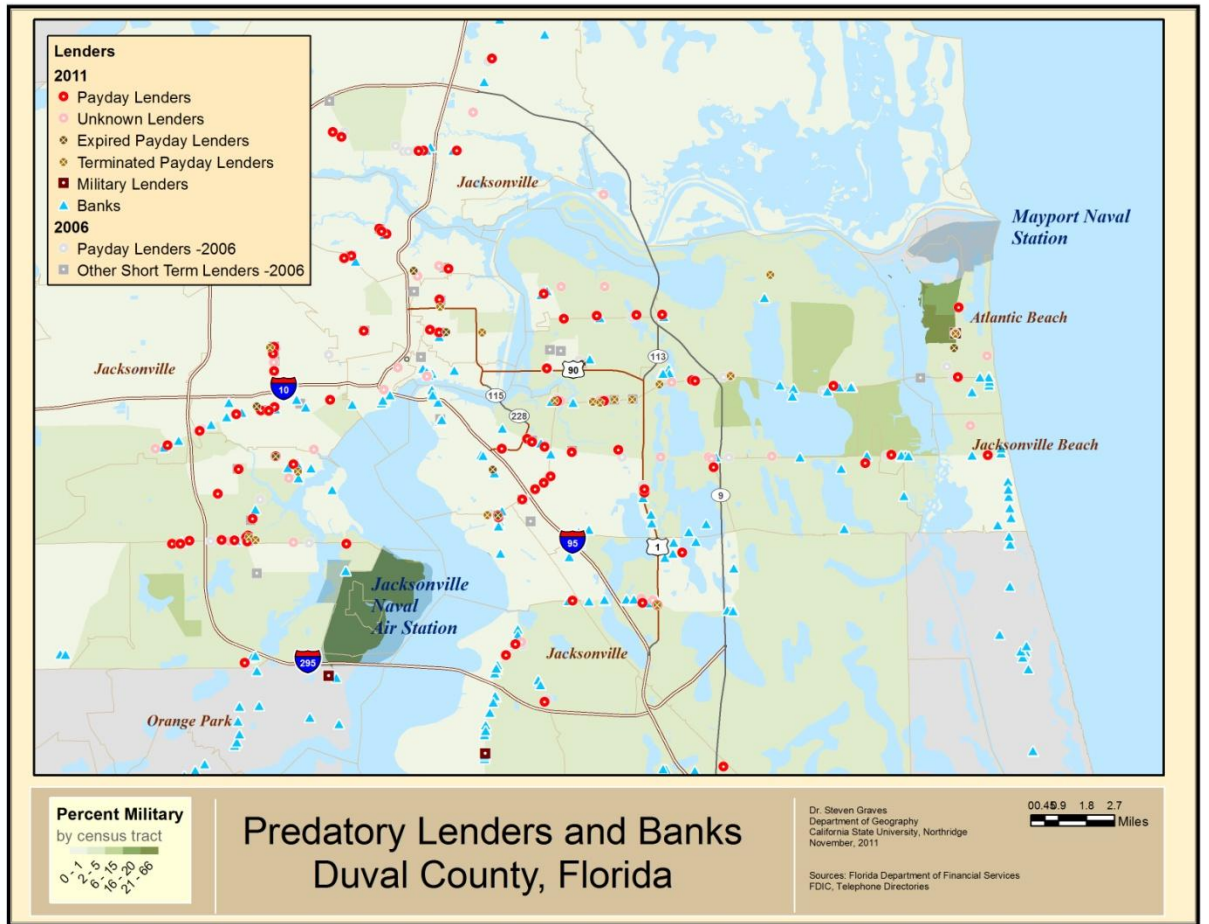
This trend is disturbing because it seems to suggest that this military neighborhood is still a target of the payday lending industry in Florida. The census tracts in 32210 do not have a demographic profile commonly associated with heavy payday lending activity (high percent minority, high poverty rate, e.g.). Certainly 103rd Street (State Highway 134) is a well-travelled commercial thoroughfare, but the concentration of payday lenders, especially as a ratio to FDIC-insured banks in this region, strains against any argument that military families have diminished as a favored target demographic for payday lending in Florida. Florida is another state that seems to lack either the will or the means to enforce the MLA.

The concentration of payday lenders near the Mayport Naval Base is less noteworthy, as is the case near many naval bases. Military families tend to be less concentrated in single neighborhoods, making them a more diffuse target for predatory lenders. The situation in several ZIP Codes near Mayport remains largely unchanged from 2004.

⁹² Earlier databases available from the Florida Department of Financial Services included a column indicating the status of licensee operating as a “deferred presentment provider”, or payday lender. In 2011, that column is missing from the database, thus requiring an alternative data gathering methodology. The recent database was created by eliminating those businesses obviously engaged in other types of lending, including nationally recognized payday lenders, and phoning lenders on the roster provided by the Florida Department of Financial Services that remained uncertain to inquire if they offered “payday loans”.

⁹³ See Graves and Peterson (2005 p 742-743). Data acquired from the Florida Department of Financial Services, Licensing and Registration Division (<http://www.dbf.state.fl.us/licensing/download.html>) Last accessed December 12, 2003.

⁹⁴ By our count, derived from information downloaded from the Florida Department of Financial Services, Office of Financial Regulation Public License Download Site, Money Services Business List (<http://www.flofr.com/Consumer/Download.aspx>), last accessed July 7, 2011.



D. Hampton Roads Region, Virginia

The cities of Virginia Beach, Norfolk, Chesapeake, Hampton, Newport News and surrounding counties constitute our next case study location. Home to Navy, Air Force, Army and Marine bases, it is perhaps the most well-known military district in the United States. The region is also unique because although the *number* of military families is high they remain a relatively small percentage of the entire region's large population. Military families in this region often live among a demographic likely to use payday and other high-cost lenders.

Payday lending has a short and turbulent history in Virginia. It was made legal in the state in 2002, and as a result of its late entry, the state had a low number and density of payday lenders in most of the state when data was first collected for Virginia. The Hampton Roads region and the area around Fort Lee were notable exceptions. For example, though the statewide ratio of banks to payday lenders was 5 to 1, in the Hampton Roads area it was already 6 to 10 (.6 to 1).⁹⁵ Between 2005⁹⁶ and 2008, the number of payday lenders increased, sometimes doubling in places like Virginia Beach, Portsmouth, Newport News and Norfolk. There was reduction in some of the other ZIP codes in the region as well but not more than one per ZIP Code during the 2005-2008 period. By 2008, nine of the top ten ZIP codes in Virginia for total payday lenders were in proximity to a military base.⁹⁷ Seventeen of the top thirty ZIP Codes for payday lenders were in the Newport News to Virginia Beach corridor. The picture remains similar in 2011, but the numbers of "payday lenders" licensed by the Virginia Bureau of Financial Institutions has fallen dramatically, largely as a result of state law changes and subsequent lender shut-downs or efforts to evade loan restrictions.⁹⁸

Recent changes in Virginia law regulating payday lending⁹⁹ have caused a significant reduction in the number of payday lenders and the manner in which they are licensed. Because a number of payday lenders now operate as unlicensed "Open-End" lenders, it has become more difficult to ascertain with great certainty where high cost, short-term lenders are actually doing business.

The news following the most recent law changes appears to be mostly good for military families in the region. For example, since 2008, when the state law changed, 65 ZIP Codes in Virginia eliminated 100% of their officially licensed payday lending operations. Among those with the greatest apparent reduction in payday lenders and percentage loss of payday lenders were several in the Hampton Roads region. For example, every payday lender in Virginia Beach's 23455 ZIP Code appear to be closed. All five of the payday lenders in Portsmouth's 23703 ZIP Code from 2008 are now apparently closed. However, Norfolk's 23504 ZIP Code, which had only one

⁹⁵ See Graves and Peterson (2005, 811)

⁹⁶ Commonwealth of Virginia State Corporation Commission, Bureau of Financial Institutions, Payday Lenders Licensed in Virginia, available at <http://www.scc.virginia.gov/division/banking/payday.htm> (downloaded October, 17, 2005).

⁹⁷ Commonwealth of Virginia State Corporation Commission, Bureau of Financial Institutions, Payday Lenders Licensed in Virginia, available at <http://www.scc.virginia.gov/division/banking/news/pay.pdf> (downloaded January 18, 2008)

⁹⁸ Commonwealth of Virginia State Corporation Commission, Bureau of Financial Institutions, Payday Lenders Licensed in Virginia, available at http://www.scc.virginia.gov/bfi/reg_inst/sur/pay_sur_0410.pdf (downloaded July 11, 2011)

⁹⁹ VA. CODE ANN. § 6.1-459.1(v). Changes to Virginia Payday Loan Act took effect January 1, 2009, requiring lenders to give borrowers a repayment period two times longer than the borrower's pay cycle.

payday lender in 2008 added one by 2011, making it one of only eight (out of nearly 850) ZIP Codes in Virginia to actually add one or more payday lenders and the only place to double its total during this period. The percentage loss of payday lenders from 2008 to 2011 was slightly greater (down 71%) in ZIP Codes near military bases in the Hampton Roads Region compared to those more clearly dominated by a civilian population elsewhere in the state (down 66%), which could signal that payday lenders' enthusiasm for business in military towns dropped more than it did elsewhere in the state

The reduction in predatory lending, especially around military bases is encouraging, but it may be a bit illusory. For example, it appears that Norfolk has experienced a reduction from 47 payday lenders in 2008, to 22 payday lenders in 2011. However, some of the payday lenders that appear to have closed actually are now operating under a different business model and a different statute. According to a recent telephone survey of Norfolk former payday lenders that surrendered their licenses following the change in state law in 2008, five have begun operating as "open-end" lenders. The same telephone survey found six open-ended lenders in Chesapeake, five in Hampton, five in Newport News and at least 10 in Virginia Beach.¹⁰⁰ It is difficult to be certain of the causal factors behind the reduction in payday lending in Virginia's military towns. It would be easy to argue that changes in state regulations have been a much stronger factor in the reduction of payday lending in Hampton Roads region than changes in federal law. Still, it would be fair to attribute some credit to the MLA of 2007, which added another disincentive to payday lending in military districts. Clearly the Hampton Roads region has far fewer licensed payday lenders than was the case in either 2005 or 2008 but it remains to be seen how many of those will ultimately exchange their license as a payday lender for one that allows them to market another, similarly dangerous loan product. The recent Virginia car title loan legislation requires that loans be structured as closed-end credit and requires lenders to comply with the federal Military Lending Act.¹⁰¹

¹⁰⁰ Telephone survey conducted by Consumer Federation of America staff, using telephone directories and the list of "surrendered licenses" provided by the Commonwealth of Virginia State Corporation Commission, Bureau of Financial Institutions in 2011. Phone numbers were cross referenced with the state licensee list from 2008.

¹⁰¹ Chap. 21 Title 6.2 Code of Virginia



E. Fort Leonard Wood, Missouri

Fort Leonard Wood is the largest military installation in Missouri and nearby St. Robert is almost exclusively a “military town.” The density of payday and other high-cost lenders cannot be attributed to a local population that would be interspersed with the military population as found, for example, in San Diego or Hampton Roads, Virginia.

St. Robert (ZIP 65584, population 5,166) had eight payday lenders and only two banks in 2004.¹⁰² In the Graves and Peterson study of payday lending at military bases, St. Robert ranked as the second worst ZIP Code in all Missouri in terms of payday lenders per capita.¹⁰³ In January, 2007, there were still seven licensed payday lenders in St. Robert. Today, only four licensed payday lenders remain, a significant reduction from 2004.¹⁰⁴

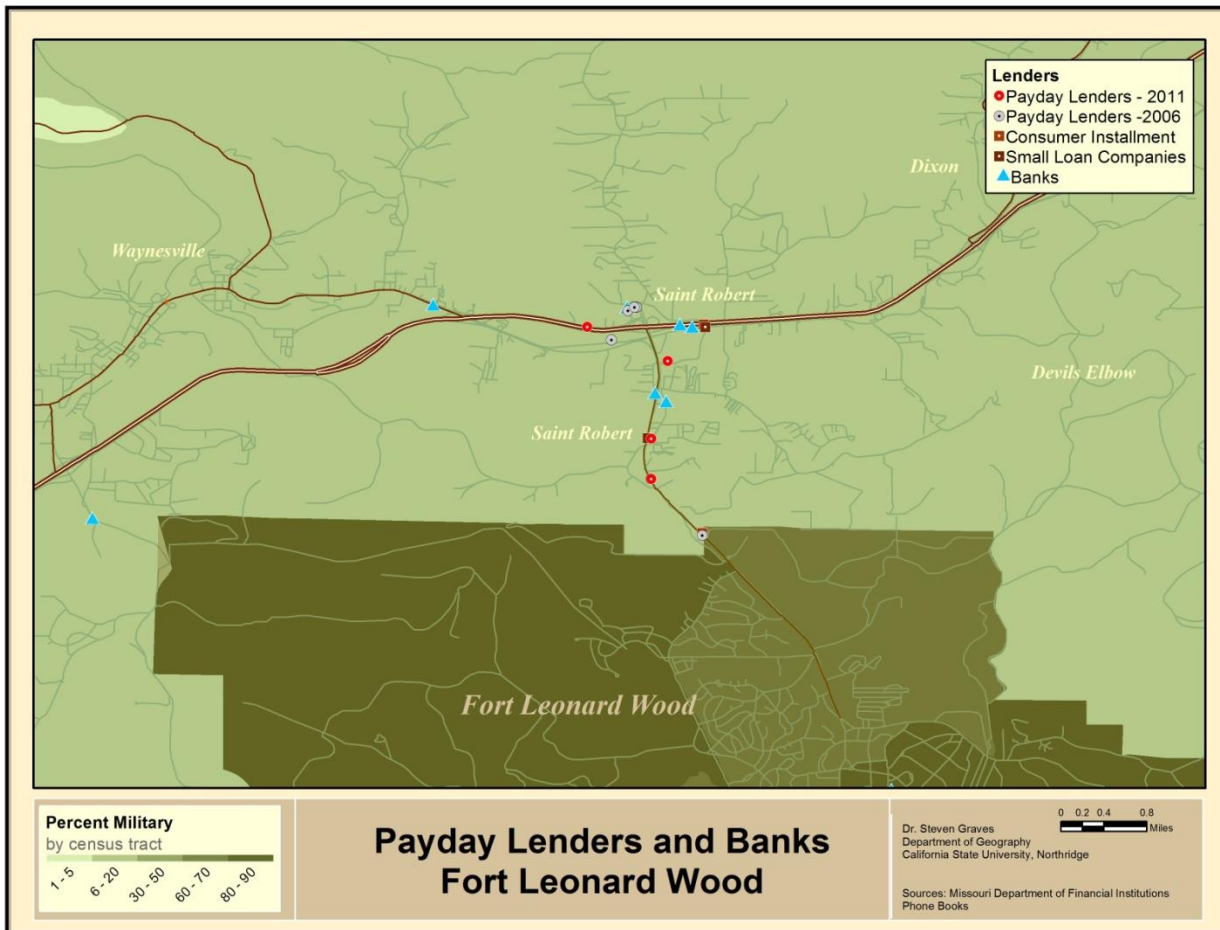
While the number of payday loan outlets in Missouri has dropped during this time period (1,138 in 2004 compared to 928 today), the reduction in St. Roberts is more than double that of the statewide percentage loss of licensed outlets. Several other small towns with notable excesses of payday lending also saw some reduction in payday loan stores, yet among all ZIP codes with fewer than 10,000 persons (like St. Robert), there was a small *increase* in payday lending in Missouri. The MLA may be having the desired effect in Missouri.

Still, with a population of around 5,000, we would expect to find only one payday loan outlet, not the four that continue to operate in St. Robert. This suggests that there may still be some lending to military families by the four payday lenders that remain parked outside the gates of Fort Leonard Wood, or those stores are also selling credit products not subject to the MLA. In addition to payday loan outlets, an additional three loan companies operate in St. Robert, including World Acceptance with two licenses. The persistence of predatory lenders around Fort Leonard Wood can also legitimately be attributed to the stubbornness of the Missouri legislature to regulate high cost lending in the state. Missouri remains one of the states most favorable to predatory lending nationwide, with a permissible APR of over 1500%.

¹⁰² State of Missouri, Division of Finance, Section 408.500, Small Loan Companies (Dec. 16, 2004) available at <http://www.missouri-finance.org/pdfs/smallloans.pdf>. Last accessed 12/16/2004, on file with author.

¹⁰³ Graves, Steven M. and Peterson, Christopher Lewis. Predatory Lending and the Military: The Law and Geography of 'Payday' Loans in Military Towns (October 05, 2010). *Ohio State Law Journal*, Vol. 66, p. 765, 2005

¹⁰⁴ Missouri Division of Finance, Bank and Licensee Search. <http://finance.mo.gov/licenseesearch/> (Accessed August 25, 2011). On file with CFA.



F. Joint Base Fort Lewis & McChord, Washington

The region around the recently consolidated Fort Lewis Army base and McChord Air Force base has witnessed a pattern of change that is different still from the other military towns we have analyzed. The State of Washington changed the legal environment for short term lenders drastically since the passage of the MLA in 2007, by limiting the total number of payday loans per borrower to eight per year from all lenders. As a result, there has been a mass exodus of payday lenders from Washington State in general and an even greater exodus from military towns, like Lakewood which borders Lewis-McChord.

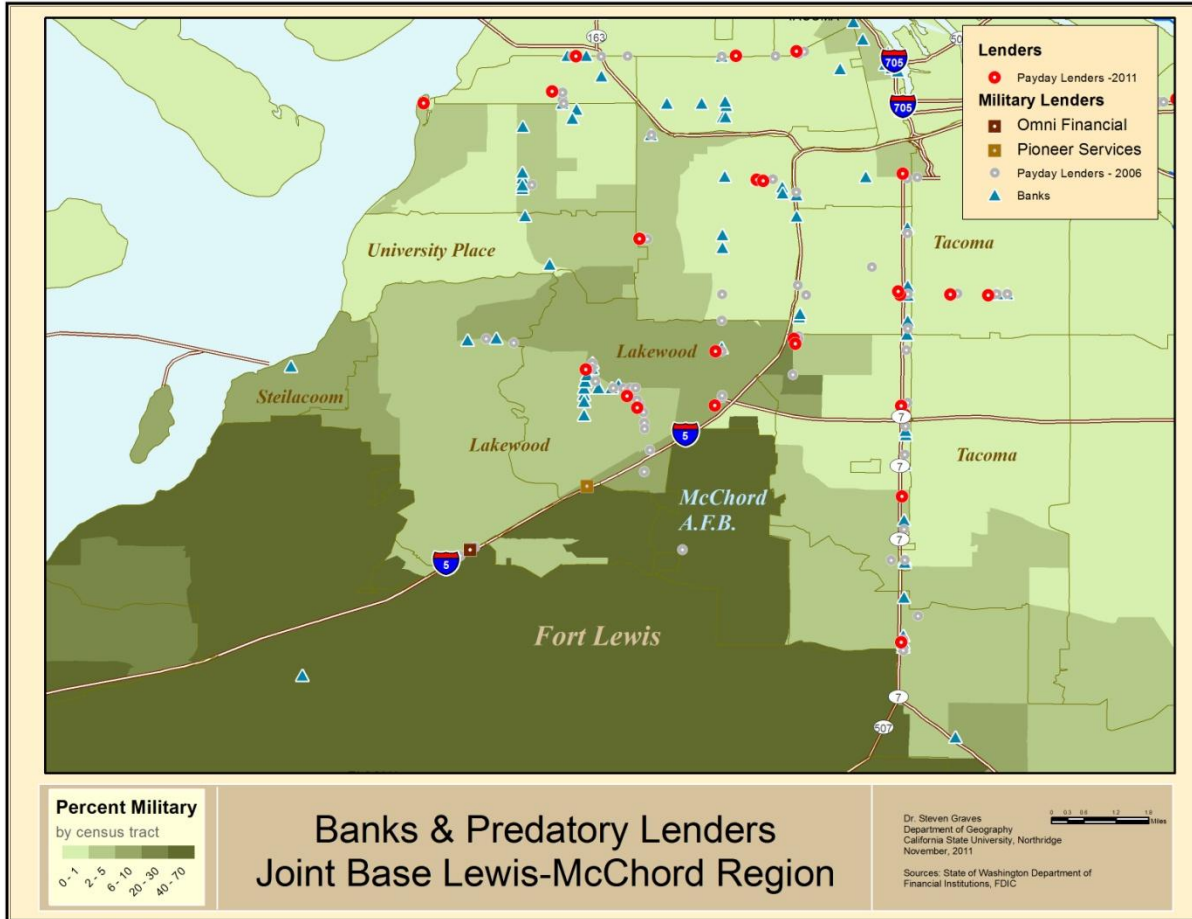
Consider for example that in 2003¹⁰⁵, there were 12 payday lenders in Lakewood, and by 2006, there were 19.¹⁰⁶ At that time, Lakewood's 98499 ZIP Code, directly adjoining the main gate of Fort Lewis, had the most payday lenders of any ZIP Code in the entire state (16) and ranked near the top in per capita and business density for payday lending as well. Lakewood had the greatest concentration of high cost lenders in the state. Not far behind in terms of payday lending activity were other nearby ZIP codes, including Tacoma's 98444 and Lakewood's 98498 ZIP codes. In all, the McChord-Lewis region stood out as one of the most intense clusters of payday lending activity in the entire United States in 2006, with enough payday lending over-capacity to serve nearly a half million additional residents.

Today, Lakewood has 5 payday lenders, a reduction to levels that are more in line with what one would expect, given the population in the area.¹⁰⁷ Tacoma still has 18 payday lenders, but that's reduced from the 46 that were there in 2006, prior to the passage of the MLA and changes to state laws. Where once there were 75 payday lenders in the region, there are only 28 now in the same region. The reduction statewide has been impressive, but the decline in payday lending has been most precipitous in the neighborhoods adjacent to McChord-Lewis, suggesting that the MLA has been partly effective in Washington. Car title lending is not authorized in Washington.

¹⁰⁵ Washington State Department of Financial Institutions, Division of Consumer Services <http://www.dfi.wa.gov/cs/licenseelist031117.xls> (downloaded November 26, 2003)

¹⁰⁶ Washington State Department of Financial Institutions, Division of Consumer Services <http://www.dfi.wa.gov/cs/docs/licenseelist.xls> (downloaded February 17, 2006)

¹⁰⁷ Washington State Department of Financial Institutions, Division of Consumer Services <https://fortress.wa.gov/dfi/licenselu/dfi/licenseLU/LicenseLLU.aspx> (accessed October 21, 2011)



VII. Bank Payday Loans Not Covered by MLA Rules

Other forms of credit that mirror payday loans have emerged since MLA rules were written in 2007, such as the explosion in overdraft loans and spread of direct deposit advances. At the time MLA rules were being written, advocates unsuccessfully urged the Defense Department to define consumer credit broadly to include similar products, regardless of whether the loan was provided by a bank or a non-bank lender. Exclusions in the DoD regulations for bank payday loans leave military consumers exposed to debt trap problems caused by their banks.

Loans Based on Direct Access to Consumers' Bank Accounts

Mandatory bank account ownership makes servicemembers eligible for several types of high-cost credit products from financial institutions repaid directly from their bank account. The Military Lending Act banned loans based on unfunded checks or electronic debits from accounts, effectively banning payday loans made at stores or online. Banks make two types of credit available that are payday loans in structure, cost, and impact on borrowers. Like payday loans, overdraft loans and direct deposit advances cost triple-digit rates, have proceeds deposited into the borrower's bank account, are paid through unilateral withdrawal of funds from the next deposit to 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.

A. Overdraft Loans

Overdraft loans are very similar to payday loans but are not prohibited by the DoD rules implementing the Military Lending Act. The DoD rules specifically exempt credit not subject to the Truth in Lending Act. The definition of "consumer credit" excludes "(v) Any other credit transaction that is not consumer credit extended by a creditor, is an exempt transaction, or is not otherwise subject to disclosure requirements for purposes of Regulation Z (Truth in Lending), 12 CFR part 226." Since the Federal Reserve has not required banks to comply with the disclosure requirements of Truth in Lending, overdraft loans are excluded from MLA protections under this rule.¹⁰⁸ As a result, banks extend credit to servicemembers at abusive rates and terms that mirror payday loans. The FDIC reported that a \$20 debit card overdraft at the cash register with an overdraft fee of \$27 repaid in two weeks costs 3,252 percent APR if computed as a closed-end payday loan.¹⁰⁹ While a payday loan at this rate would be prohibited by DoD rules, a bank equivalent is not covered because the cost of the credit is not disclosed under TILA rules.

¹⁰⁸ 32 CFR Part 232.3(b)(2)(v). Overdrafts triggered by a debit card at the point-of-sale or ATM are subject to Reg E rules adopted by the Federal Reserve. Overdrafts triggered by other transactions are excluded from Reg Z.

¹⁰⁹ Karen Jowers, "Don't Get Burned," *Army Times*, October 10, 2011, p. 6-7.

Bank overdraft loans mirror payday loan terms and structure. Banks extend credit when transactions are paid on insufficient funds. Loans are due in one lump sum in just days, with payment taken directly from the consumer's next deposit to the account, and cost triple-digit rates when compared to the payday loans banned by the Military Lending Act. CFA's most recent survey of overdraft fees and terms charged by the fourteen largest banks found that the typical fee is \$35 per overdraft with two-thirds of the largest banks piling on second and multiple fees if consumers do not repay overdrafts in just a few days. Banks repay themselves directly from the next direct deposit of income into the account if consumers have not repaid sooner to avoid sustained overdraft fees. A \$100 overdraft loan repaid in two weeks, if computed as a closed-end payday loan, has APRs that range from 910 percent to 3,259 percent APR.¹¹⁰

According to *Army Times*, one-quarter of active-duty spouses surveyed by the Department of Defense reported paying overdraft fees two or more times per year, about the same proportion of over-drafters in the general population found by the 2008 FDIC survey of banks.¹¹¹ The President of the Navy-Marine Corps Relief Society testified to the Senate Banking Committee that overdraft penalty fees are the top problem at all but four of the fifty-one offices of the charity that counseled one out of every five Sailors and Marines in 2010. One example in his testimony was a Marine lance corporal from Camp Lejeune, North Carolina, whose entire paycheck was consumed by overdraft charges and related fees.¹¹² Other examples of the burden caused by overdraft loans to military consumers:

A Navy E2, based at Quantico, VA, seen by the NMCRS one month after his 21st birthday, with a wife and one child, had overdraft protection payments due after every payday. When seen by the NMCRS, the member had six credit cards, one loan consolidation debt and one personal loan. The Society helped with a loan for food, gas and diapers, as well as financial education and referrals for more in-depth counseling.

An active-duty E-5, based in Corpus Christi, Texas, with a wife and two small children was in a cycle of overdraft that he had been unsuccessful in resolving following a high interest internet loan. The family went into their overdraft when his child required medical care at a facility in another town, but the distance was not far enough for Tricare to cover travel expenses. By the time the couple sought assistance, they had suffered four back-to-back paydays on which \$500 was taken by the bank to zero out overdraft funds

¹¹⁰ Consumer Federation of America, "2011 CFA Survey of Big Bank Overdraft Loan Fees and Terms", www.consumerfed.org/pdfs/OD-14BankSurvey-ChartAugust2011.pdf, posted August 3, 2011.

¹¹¹ Karen Jowers, "Don't get burned," *Army Times*, October 10, 2011, p. 6-7.

¹¹² Testimony, Admiral Steve Abbot, President, Navy-Marine Corp Relief Society, Senate Banking, Housing and Urban Affairs Committee hearing on Protecting the Military in the Consumer Financial Marketplace, November 3, 2011.

and fees. NMCRS helped the family with basic living expenses and provided financial counseling.¹¹³

A Tennessee soldier was charged \$35 for each transaction that overdrew his account while serving in Iraq. The fifteen pending transactions were for as little as six cents, but each triggered a \$35 fee for a total of \$560 when the bank processed the largest \$300 payment first before paying the smaller payments. Had the bank processed the transactions in the order received or smallest first, only one \$35 overdraft fee would likely have been incurred.¹¹⁴

An Army financial counselor reported that one client gave twenty percent of his military pay to his bank in the form of overdraft fees at \$38 per overdraft. Another client racked up \$700 in overdraft fees in just one month as his bank charged \$35 each time his debit card was permitted to overdraw the account.¹¹⁵

¹¹³ Testimony, Admiral Steve Abbot, President, Navy-Marine Corp Relief Society, Senate Banking, Housing and Urban Affairs Committee, hearing on Protecting the Military in the Consumer Financial Marketplace, November 3, 2011.

¹¹⁴ NEWS 2 WKRN ABC, Nashville, TN, "Bank overdraft fees burden local soldier in Iraq," May 28, 2009 at www.wkrn.com.

¹¹⁵ Electronic communication with financial counselor, January 27, 2010. On file with CFA.

Survey of Military Bank Overdraft Loans and Fees

CFA reviewed the fees and terms for overdrafts at all banks with branches on military bases¹¹⁶ to see if overdraft fees are charged and if customers are given the means to opt-in to pay overdraft fees on debit card point of sale purchases and ATM withdrawals. The survey also noted when banks lower-cost ways to cover overdrafts, such as transfer from savings, a credit card, or a line of credit at the bank. CFA found that the overdraft fees charged on base are almost always identical to the same bank's fee schedule off-base. CFA surveyed the banks' websites and called branches to collect information not available on websites. See chart below.

Our findings indicate that almost 90 percent of banks with branches on military bases permit 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 Bank,¹¹⁷ 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 Bank¹¹⁸ charges an \$18 per overdraft fee and permits up to seven fees in one day for a total of \$126.

The largest banks charge the steepest overdraft fees. Regions Bank, with a branch at Redstone Arsenal in Alabama, charges \$36 per overdraft item up to six per day on any overdraft over \$5.¹¹⁹ Bank of America charges \$35 to permit a customer to overdraw at the ATM and adds another \$35 sustained overdraft fee if the overdraft and fee are not repaid in five days.¹²⁰ Wells Fargo, which has branches at ten bases, charges \$35 per overdraft up to four per day.¹²¹ SunTrust Bank, at four bases in Georgia and Virginia, permits up to six overdrafts per day at \$36 each and a second \$36 sustained overdraft fee if not repaid in seven days.¹²²

Of the banks offering opt-in to pay overdraft fees on debit card purchases and transactions, some limit the total number of overdraft fees charged in one day or the threshold of overdrafts that trigger fees. For example, Bank of Hawaii with a branch at Hickam Air Force Base, charges a \$26 overdraft fee and another \$10 fee if an overdraft has not been repaid in seven days.¹²³ The bank permits up to three overdraft fees in one day and does not charge a fee if the overdraft is less than \$5. Fort Hood National Bank, with a branch on base at Fort Hood in Texas, has tiered

¹¹⁶ AMBA "Bank Institutions Located on Military Installations," June 2011.

¹¹⁷ www.afbank.com/optin, visited 5/10/2012

¹¹⁸ www.fsnb.com/pages/overdraft.html, visited 5/10/2012

¹¹⁹ www.regions.com/faq/coverage.rf, visited May 10, 2012.

¹²⁰ https://www.bankofamerica.com/deposits/index.action?body=check_compare

¹²¹ www.wellsfargo.com/checking/overdraftservices/index, visited May 10, 2012.

¹²² SunTrust Personal Deposit Accounts Fee Schedule, effective March 1, 2012.

¹²³ <https://www.boh.com/personal/banking-products/checking/understanding-overdrafts.asp>, visited May 11, 2012

overdraft fees ranging from \$19 to \$35 with six per day permitted.¹²⁴ There is no overdraft fee at Fort Hood if the overdraft is less than a dollar or if the account is negative less than \$3.

The chart below lists the bank, the website for the bank, the bases where branches were located as of June 2011, fees and limits for all types of overdraft transactions, lower cost overdraft protection, and whether the bank charges overdraft fees on debit card point of sale and/or ATM transactions if the customer opts in to this form of overdraft coverage. If a customer does not opt in, or if the bank does not permit debit card transactions to overdraw the account, the transaction is rejected and no fee is charged.

Bank Name	URL	Branch Locations	Standard OD	OD Protection	Opt In?
Armed Forces Bank, N.A. (OCC)	www.afbank.com	Fort Rucker, AL, Fort Huachuca, AZ(x2), Luke AFB, AZ(x2), MCAS Yuma, AZ, Edwards AFB, CA, Fort Irwin, CA(x2), NAS Lemoore, CA, NB Coronado, CA, NB Point Loma, CA(x2), Port Hueneme, CA, NB San Diego, CA(x4), Travis AFB, CA(x2), Vandenberg AFB, CA, Fort Carson, CO(x2), USAFA, CO(x2), MacDill AFB, FL, Tyndall AFB, FL, Moody AFB, GA, NS Great Lakes, IL(x3), Fort Leavenworth, KS(x3), Fort Riley, KS(x3), Fort Knox, KY(x3), Fort Leonard Wood, MO(x2), Nellis AFB, NV(x2), McGuire AFB, NJ, Grand Forks AFB, ND, Fort Bliss, TX(x3), Myer-Henderson Hall, VA(x2), NS Norfolk, VA, Fairchild AFB, WA, Fort Lewis-McChord, WA(x5), NB Bremerton, WA, NSB Bangor (2), WA, FE Warren AFB, WY	\$25 fee per item, max of \$125 per day. No fee for OD less than \$10 or on transactions less than \$5	\$7 per daily OD protection transfer from savings, 15.9 % APR for OD line of credit	Yes
Bank of America Military Bank (OCC)	www.bankofamerica.com/military/	Davis Monthan AFB, AZ, Bolling AFB, DC, Pentagon, VA, U.S. State Dept., DC, Washington Navy Yard, DC, NS Mayport, FL, Patrick AFB, FL, Fort Campbell, KY, Aberdeen Proving Ground, MD, Fort Meade, MD, Cannon AFB, NM, Grand Forks, ND, Charleston AFB, SC, Dyess AFB, TX, Joint Base San Antonio, San Antonio, TX, Amphibious Base, VA, Fort Eustis, VA, MCB Quantico, VA(x3), NS Norfolk, VA, NAS Oceana, VA, Pentagon Reservation, Arlington, VA	\$35 per item, max of 4 per day \$35 sustained overdraft after each 5 days of negative balance	\$10 per OD protection transfer from another checking or savings account, or line of credit. Can link checking account to a Bank of America credit card for overdraft protection.	No for debit card purchase Yes for ATM overdraft

¹²⁴ https://www.fhnb.com/en/forms/frmodelection_step1.php?func=print, visited May 12, 2012.

Bank Name	URL	Branch Locations	Standard OD	OD Protection	Opt In?
Regions Bank (FRB)	www.regions.com	Redstone Arsenal, AL	\$36 per item, max 6 per day, no fee for OD of \$5 or less	OD protection is offered with transfer from deposit account, credit card or line of credit	Yes
Fort Sill National Bank (OCC)	www.fsnb.com	MC Recruiting Depot San Diego, CA, Dover AFB, DE, MCAS New River, NC, Fort Sill, OK, MC Recruit Depot Parris Island, SC, Sheppard AFB, TX	\$18 per item, max 7 per day	Transfer from savings to checking, \$2 fee per transfer	Yes "Recruit" acct. up to \$200 in OD limit
5 Star Bank (FDIC)	www.5starbankus.com	Peterson AFB, CO (x2)	\$30 fee for overdrafts plus \$3 per day until the account shows a positive balance for checks, ACH	Overdraft line of credit available, \$10 per year plus interest. Transfer from savings no fee, limit six per month.	No
Coastal Bank and Trust (FDIC)	www.coastalbankandtrust.com	Eglin AFB, FL	\$29 fee for military, OD collection fee of \$35 if negative 7 days	\$10 fee for transfer from savings; a transfer from credit card charged as cash advance, line of credit	Yes
First National Bank Alaska (OCC)	www.fnbalaska.com	Elmendorf AFB, AK	\$20 OD/NSF	Transfer from savings or to credit card, \$5	No
First Arkansas Bank and Trust (FDIC)	www.firstarkansasbank.com	Little Rock AFB, AR	\$28 fee. Limit \$500 overdrawn. No fee if \$5 or less overdrawn	Transfer from savings cost \$5 per transfer	Yes
First National Bank and Trust (OCC)	www.fnbt.com	Hurlburt Field AFB, FL	\$35.50 fee	Link to savings or money market acct. or LOC, \$8 transfer fee	Yes
First Navy Bank (FRB)	www.firstnavybank.com	Naval Air Station Pensacola, FL	\$18 per item, no limits, up to \$200 in OD	Not offered	Yes
Columbus Bank & Trust Co. (FDIC)	www.columbusbankandtrust.com	Fort Benning, GA(x2)	\$29 fee for military. \$35 OD collection fee after 7 days. No fee if \$5 or less total OD. 6 fee per day limit.	\$10 fee for transfer from savings, transfer for credit card billed as cash advance	Yes

Bank Name	URL	Branch Locations	Standard OD	OD Protection	Opt In?
Wells Fargo Bank (OCC)	www.wellsfargo.com/military/	Fort Benning, GA, Fort Gordon, GA, Fort Dix, NJ, Holloman AFB, NM Kirtland AFB, NM, Minot AFB, ND, Jackson, SC, Shaw AFB, SC, Fort Bliss, TX, Hill AFB, UT	\$35 fee, max 4 fees per day	\$12.50 transfer from savings, \$12.50 fee for transfer from LOC, \$12.50 to \$20 credit card	Yes
The Heritage Bank (FDIC)	www.the-heritage-bank.com	Fort Stewart, GA	\$34 fee, max 4 per day	Overdraft protection from savings or credit available	Yes
SunTrust Bank (FRB)	www.suntrust.com	Robins AFB, GA, Fort Belvoir, VA, Fort Lee, VA, Langley-Eustis, VA	\$36 per item, max 6 ODs per day \$36 sustained overdraft fee on 7 th day No fee < \$5 item	Transfer from credit card, credit line, or deposit account. Fee of \$12.50 for OD protection transfers.	Yes
Bank of Guam (FDIC)	www.bankofguam.com	Andersen AFB, Guam, NS Guam, Guam	Not given	OD protection from savings account available	Not given
Bank of Hawaii (FRB)	www.boh.com	NB Pearl Harbor- Hickam AFB, HI, MCB Hawaii, HI	\$26 fee, \$10 continuous OD fee after each 7 days unpaid, max 3 OD fees per day, no fee for OD less than \$5	\$10 fee for transfer from savings, \$25 annual fee for overdraft line of credit	Yes
First Hawaiian Bank (FDIC)	www.fhb.com	Pearl Harbor- Hickam-AB, HI, Schofield Barracks, HI	\$26.50 fee, no fee for OD less than \$5, \$10 if overdrawn 7 days, limit 5 OD fees per day	Line of credit available for OD protection, link to savings	Yes
Chase Bank (OCC)	www.chase.com	Barksdale AFB, LA, Wright-Patterson AFB, OH	\$34 OD fee \$15 sustained OD fee after 5 days No fee if total OD \$5 or less Limit 3 OD fees per day	\$12 fee for transfer from credit card, savings account, or home equity line of credit	Yes
Sabine State Bank (FDIC)	www.sabinestatebank.com	Fort Polk, LA(x2)	\$27 OD fee	Not offered	Yes

Bank Name	URL	Branch Locations	Standard OD	OD Protection	Opt In?
PNC Bank (OCC)	www.pnc.com	Fort Meade, MD	\$25 fee for the first overdraft in 12 mon. \$36 fee for subsequent overdrafts, max 4 per day. No fee if overdrawn \$5 or less \$7/day sustained OD after 5 days, max \$98 Limit 4 OD/day	OD protection available from checking, savings, money market account, line of credit, or credit card for \$10 per transfer	Yes
BancorpSouth Bank (FDIC)	www.bancorpsouthonline.com	Keesler AFB, MS	\$35 fee. After 10 days unpaid, \$35 continuous overdraft fee	Overdraft protection available using credit card or line of credit	Yes
UMB Bank (OCC)	www.umb.com	Whiteman AFB, MO	\$36 fee. If overdrawn more than 5 days, \$8 per day up to 20 days	OD protection with line of credit, credit card, or another account available	Yes
U.S. Bank (OCC)	www.usbank.com	Malmstrom AFB, MT	\$10 fee for under \$20, \$33 fee for over \$20, max 3 OD and 3 NSF per day \$25 per week sustained OD fee on 8 th day	\$10 fee for OD protection transfer from account, line of credit, or credit card	Yes
Great Western Bank (FDIC)	www.greatwesternbank.com	Offutt AFB, Nebraska	\$33 OD fee, daily max of \$165. If overdrawn 2 days, \$4 per day.	Offers OD protection with transfer from another account or a line of credit	Yes
KeyBank, N.A. (OCC)	www.key.com	Fort Drum, NY	\$34 fee first 2 times, \$38.50 after that. \$28.50 after account negative 5 days. No limit on # of OD fees.	Overdraft protection line of credit offered up to \$10,000, \$10 fee for each advance and \$25 annual fee	Yes
First Citizens Bank (FDIC)	www.firstcitizens.com	Fort Bragg-Pope Field, NC, Camp LeJeune, NC, MCAS Cherry Point, NC	\$35 fee, limit 4 per day. No fee if OD \$5 or less.	\$10 fee for transfer from savings or line of credit	Yes

Bank Name	URL	Branch Locations	Standard OD	OD Protection	Opt In?
NBC, Altus AFB Branch (FDIC)	www.nbcokonline.com	Altus AFB, OK	\$29 fee of check or ACH is paid on insufficient funds	Overdraft protection available with another checking or savings account, \$5 transfer fee	No
First National Bank of Midwest City (OCC)	www.fnbmwc.com	Tinker AFB, OK(x2)	\$32 fee	OD protection is available with transfer from savings, line of credit	Yes
Broadway National Bank (OCC)	www.broadwaybank.com	AMEDD Center, TX, Brooke Army Medical Center, TX, Joint Base San Antonio, TX(X3),	\$28 fee	OD protection from checking or savings, are \$8 per transfer. Line of credit.	Yes
Fort Hood National Bank (OCC)	www.fhnb.com	Fort Hood, TX	Tiered fee of \$19, \$29, or \$35. Limit 6 per day. No fee if OD less than \$1 or if negative less than \$3	Account transfer offered	Yes
Old Point National Bank (OCC)	www.oldpoint.com	Fort Monroe, VA	Up to \$30 fee, max \$150 per day	Line of credit or account transfers available	Yes
USAA (OCC)	https://www.usaa.com	Bank Branch located in San Antonio, TX. Financial centers are located in: Annapolis, MD; Arlington, VA; Colorado Springs, CO; Fayetteville, NC; Highland Falls (West Point), NY; Killeen, TX; Oceanside, CA; San Antonio, TX; and San Diego, CA.	\$25 fee, limit 2 per day, checks and ACH payments only. Debit cards cannot overdraw account.	OD protection is available through a linked credit card, savings, or checking account. No additional fees are charged for overdraft protection except for cash advance fees associated with credit card.	No

Updated May 14, 2012

Recommendation: The Consumer Financial Protection Bureau should revise regulations under the Electronic Fund Transfer Act to prohibit overdraft fees triggered by debit cards at point-of-sale or ATM. There are no fees avoided when debit POS/ATM transactions are declined for insufficient funds. This change to Reg E under the Electronic Fund Transfer Act would protect all consumers from astronomically expensive balloon payment small loans repaid directly from deposit accounts and would also protect military families without banks having to identify covered borrowers.

Recommendation: CFPB or Congress should extend Truth in Lending Act protections to all forms of overdraft lending, including overdrafts triggered by checks, ACH transactions, and recurring debits. Besides giving consumers a comparable cost of credit price tag, a side benefit of TILA coverage is that high-cost bank overdraft loans would then be covered by the DoD MLA rules and prohibited for covered servicemembers when the cost exceeded 36 percent.

Recommendation: The Department of Defense should revise its definition of consumer credit to remove the provision that exempts credit not subject to the Truth in Lending Act and that exempts credit paid by set-off. This change would protect servicemembers from extremely high-cost overdraft loans by including overdraft loans under the rules for payday lending.

Recommendation: Base commanders who negotiate contracts for financial institutions allowed to do business on bases should address overdraft practices. On-base financial institutions should be prohibited from charging overdraft fees for debit card point of sale and ATM transactions and should strongly encourage banks to provide overdraft transfer services, low-balance alerts, and affordable overdraft lines of credit to accountholders who qualify.

B. Bank 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/s to the account or within 35 days at most. If deposits are not sufficient to repay the loan and fees in full, the bank repays itself anyway, even if the repayment overdraws the consumer's account, triggering more costs through overdraft fees.

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.¹²⁵ Many borrowers take out ten, twenty or even thirty or more bank payday loans in a year.¹²⁶

¹²⁵ Center for Responsible Lending, "Big Bank Payday Loans," CRL Research Brief, July 21, 2011, available at www.responsiblelending.org/payday-lending/research-analysis/big-bank-payday-loans.pdf.

¹²⁶ *Id.*

Bank direct deposit advance loans carry the same high cost, short term, debt-trap features as non-bank payday loans. Banks claim that the direct deposit advance loans are “open-end” credit because consumers can repeatedly draw on credit although payment in full is required, typically within 35 days.¹²⁷ The National Consumer Law Center argues that the claim to be “open-end” credit is questionable, since the finance charge is not “computed from time to time on an outstanding unpaid balance,” as required in the Truth in Lending Act definition of what constitutes open-end credit.¹²⁸ Bank payday loans are not banned by the MLA rules because the loans are purportedly structured as open-end credit while the Department of Defense rules define payday loans as closed-end credit.¹²⁹

Bank Direct Deposit Advance Terms: National Consumer Law Center Issue Brief: “300% Bank Payday Loans Spreading,” August 2011

Bank	Terms	Cost for \$400, 10-day loan	APR for 10-day \$400 Loan	Offered in States That Restrict Payday Loans
Fifth Third Bank	\$10 per \$100	\$40	365%	OH
GuarantyBank	\$30 application fee	\$30	274%	GA
Regions Bank	\$10 per \$100 \$15 returned payment fee	\$40	365%	AR, GA, NC, VA
U.S. Bank	\$10 per \$100 \$35 late fee	\$40	365%	AZ, AR, MT, OH, OR
Wells Fargo	\$7.50 per \$100 \$35 late fee	\$30	274%	AZ, MT, OR (coming soon to Wachovia branches in CT, GA, MD, NJ, NY, PA, VA)

Of the large banks marketing direct deposit advance loans to consumers, three have branches on military bases and a fourth bank, Fifth Third, markets special account features to military customers. CFA contacted at least one on-base branch per bank with a direct deposit advance product to ask if this loan is available to servicemembers and got an affirmative response for each bank. A review of eligibility criteria does not indicate that servicemembers are not eligible. For example, Regions Ready Advance requires only that borrowers have an active eligible checking account at Regions for at least nine months, with combined monthly direct deposit of at least \$100, not linked to a credit product for overdraft protection, and currently not in derogatory

¹²⁷ Karen Jowers, “Need emergency cash? Look to relief societies first,” *Army Times*, April 26, 2010, p. 5.

¹²⁸ National Consumer Law Center, *The Cost of Credit* (4th ed. 2009) p. 40.

¹²⁹ CFA Fact Sheet, “Predatory Lending Protections for Servicemembers,” October 1, 2007, at <http://www.consumerfed.org/pdfs/MIL-Fact-Sheet-Final-Regs.pdf>.

status. The Regions FAQs say nothing about military status of the accountholder.¹³⁰ Wells Fargo's Direct Deposit Advance is not available for accounts held by minors or for accounts that have a representative payee, but do not block use by servicemembers.¹³¹ U.S. Bank's Checking Account Advance does not exclude servicemembers from eligibility.¹³²

While we have not identified individual servicemembers who are using direct deposit advance loans, financial counselors confirm that these bank payday loan equivalents are being made available and causing problems for servicemembers. Unless regulators intervene, bank payday lending is likely to spread widely. Fiserve, Inc., a software provider, is marketing its Relationship Advance direct deposit advance product to banks across the country.¹³³ Just as with storefront and online payday lending, bank direct deposit advance loans erode the assets of borrowers; lead to uncollected debt, cause bank account closures; and discourage thrift.¹³⁴

Recommendation: CFPB should investigate the bank direct deposit cash advance product and require it to be structured as a closed-end credit product that meets FDIC Responsible Small Dollar Lending guidelines. In comments filed in the CFPB docket on streamlining existing regulations, CFA and other groups recommended that all single payment loans be considered "closed-end" credit for purposes of federal law. This change would bring direct deposit advance loans within the MLA definition of a payday loan and prohibit banks from extending this high-cost product to covered servicemembers.

Recommendation: The Department of Defense should prohibit banks with branches on bases from providing direct deposit advance loans to covered borrowers. Since direct deposit advance loans mirror payday loans, DoD should be consistent in protecting servicemembers from high-cost debt traps that put bank account ownership at risk.

Recommendation: Congress or the Department of Defense should revise the MLA definition of "payday loan" to include both open-end and closed-end credit. In comments filed with CFPB,¹³⁵ CFA urged the Office of Servicemember Affairs at 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.

¹³⁰ Regions Ready Advance FAQs, www.regions.com/faq/ready_advance.rf, last viewed May 13, 2012.

¹³¹ Wells Fargo Direct Deposit Advance FAQs, https://www.wellsfargocom/help/faqs/dda_faqs, last viewed May 13, 2012. Wells Fargo has branches on bases in Utah, New Mexico, North Dakota and Texas, states where the direct deposit advance product is available. Apparently the loans are not offered to accountholders in Georgia and South Carolina.

¹³² U.S. Bank Checking Account Advance, www.usbank.com/checking/caa/agreement.html, last viewed May 13, 2012.

¹³³ www.relationshipadvance.com/ last visited March 27, 2012.

¹³⁴ Advocate letter to Federal Financial Regulators, Regarding Bank Payday Lending, February 22, 2012, available at <http://www.responsiblelending.org/payday-lending/policy-legislation/regulators/letter-to-bank-regulators-re-bank-payday-lending.html>

¹³⁵ CFA 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, September 20, 2011.

VIII. No Impact on Military Installment Loans

A sector of the installment small loan industry targets loans to military and, sometimes, federal government employees, via storefront lenders, websites, and by financing purchases at retail outlets. Typically military installment lenders promote their products and services as military-friendly, use patriotic themes in marketing, tout their executives' former experience in the service, and promote payment via allotments from military pay.

The 2006 DoD Report to Congress included military installment loans in the list of problem credit products that caused stress for military families. The report noted that lenders targeting servicemembers at stores and online operate in some states without being subject to state licensing or supervision by lending only to non-resident borrowers or servicemembers stationed in a state other than the state claimed for residency purposes. Some state small loan laws required state supervision only when loans are made to "residents," opening a loophole for military installment lenders to disregard rate caps, fee limits, loan size and collateral requirements and information disclosure requirements or other protections. The Report cited problems caused by loan flipping and packing loans with high-cost extras such as credit insurance.¹³⁶

CFA's visits to military bases garnered reports at each base that military families have financial problems with installment military loans. At Fort Leonard Wood, counselors reported that use of these longer-terms loans is up since the MLA took effect and one staff person had at least twenty active cases of families facing financial hardship due to consumer installment lenders, particularly due to the excessive fee structure of the products. Our consultant was quoted a rate of 127 percent APR for an installment loan at a lender near the gate of Fort Leonard Wood. At Norfolk, financial counselors reported that clients were given military installment loans without sufficient room in their budgets to make the required payments, raising the issue of whether lenders were adequately determining ability to repay when granting credit to be repaid via allotments. Counselors at Duval County, Florida bases, also described consumer problems caused by high-fee installment loans.

A. Unsecured Installment Loans not Covered by MLA Protections

In defining covered "consumer credit," the Department of Defense did not include longer-term, unsecured installment loans in the first round of rule-writing. A DoD spokesman told *Army Times* that "the reasons we did not include installment loans in the regulation are still relevant: There are good and bad installment loans, and we do not want to limit access to the good ones by placing blanket limitations on these loans."¹³⁷ As a result, the installment loan companies that

¹³⁶ Department of Defense, "Report on Predatory Lending Practices Directed at members of the Armed Forces and Their Dependents," August 9, 2006, pages 17-19.

¹³⁷ Karen Jowers, "Consumer Watch: Legal Installment Loans Can Still Rip You Off," *Army Times*, August 3, 2009.

have offices near military bases, provide sales financing at retailers, and market loans online primarily to the military are not covered by the MLA rate cap or other consumer protections.

B. U.S. Military Lending Corp Installment Loan Case Study

Because unsecured installment loans are not subject to MLA protections, servicemembers do not benefit from the inclusive 36 percent MAPR cap, the ban on mandatory payment via allotment from military wages, or the ban on mandatory arbitration clauses. This case study illustrates an installment loan without those protections.

An example of an installment loan sold by a surveyed lender comes from a contract with Nevada corporation US Military Lending Corp., dated December 7, 2010, for a one-year loan of \$1,500 at a disclosed **80.46 percent APR**, well above the 36 percent MAPR set by the Military Lending Act. The \$731.03 finance charge consists of \$131.03 in interest quoted as 15.75 percent and a \$600 loan fee for a total payment of \$2,231.03. Borrowers pay a five percent fee if payment is late by ten days. Paying off the balance with a credit card adds five percent of the borrowed funds balance, and a flat fee equal to five percent of each installment payment is added for all installment payments made via credit card. By signing the contract, the military borrower waives the right to a jury trial or to participate in a class action lawsuit. The lender claims application of Nevada law, regardless of the location of the borrower who must waive any claims and defenses on jurisdiction, improper venue or inconvenient forum. Despite the DFAS prohibition on mandatory payment via allotment, the contract includes in bold print:

METHOD OF PAYMENT. ALL PAYMENTS OF PRINCIPAL AND INTEREST ON THIS NOTE SHALL BE PAID IN THE LEGAL CURRENCY OF THE UNITED STATES AND ARE TO BE PAID THROUGH AN IRREVOCABLE ALLOTMENT FROM THE PROMISOR'S MILITARY SALARY. THIS ALLOTMENT SHALL BE TERMINATED UPON PAYMENT OF THIS BORROWED AMOUNT IN FULL.

The US Military Lending Corp. (USMLC) “Lending Conditions and Repayment Contract” discloses that Bank of America services all allotment repayment processes for the loan. If payment by allotment does not occur when payment is due, the military borrower agrees that USMLC will take payment within three days from his or her account via an ACH debit or collect via credit card or any means of payment included in the agreement. The Military Lending Act ban on securing loans via an allotment does not apply to this loan since the DoD definition of “consumer credit” does not apply to unsecured installment loan contracts.

Bold print in the USMLC contract says that “costs and fees are not discountable even if the funds are repaid early.” Presumably that includes the \$600 loan fee, even if the borrower repays after one month.

Among the three-page list of conditions a borrower must initial is the statement “I understand that US Military Lending Corp. may not condition an extension of credit on my repayment by preauthorized electronic fund transfers.” The final agreed statement waives coverage by the Servicemembers Civil Relief Act:

“I understand that in consideration for my borrowed funds I have knowingly and voluntarily agreed to waive any and all protections and other rights provided to me by the Servicemembers Civil Relief Act in relation to this lending conditions and repayment contract and the related promissory note, credit application, finance unit/allotment processor information release authorization, allotment change authorization, payment authorization, payment delivery instructions and federal Truth in Lending disclosures.”¹³⁸

C. Installment Loans Via the Internet and Stores

Servicemembers worldwide who have access to the Internet as well as easy access to military lenders’ stores outside the gates of many military bases can easily get into debt with installment lenders. Installment cash loans marketed specifically to the military are typically structured to be repaid in installments over one or two years via allotments from military pay. Military installment lending has spread to retail installment sales financing, where servicemembers can buy electronics and other purchases from big-box stores via closed-end loans repaid via allotments.

The 2006 Report to Congress from the Department of Defense described problems caused by installment loans that were advertised specifically to servicemembers; notably the lack of state licensing and supervision, and “loan packing” of commercial life insurance policies into “military installment loans.¹³⁹” However, the first set of DoD regulations implementing the Military Lending Act (MLA) did not define unsecured installment loans as covered by the requirements of the MLA, due to concerns about shutting off access to credit. As a result, these loans are not subject to the inclusive 36 percent Military Annual Percentage Rate cap, the prohibition on loans secured by allotments, and the ban on mandatory arbitration clauses.

¹³⁸ US Military Lending Corp. Loan Package, dated December 7, 2010, to Marine based at Parris Island, SC, on file with CFA.

¹³⁹ Department of Defense, “Report on Implementation of Limitations on Terms of Consumer Credit Extended to Service members and Dependents,” July 22, 2008, page 26.

D. Military Installment Loan Companies

Specialty military lenders include:

1. **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 claims Nevada as its choice of law for loans made via its website, regardless of where the borrower is located.¹⁴⁰ Omni lists branches in 17 states but CFA was only able to verify state licenses in nine states. Omni's brochure touts "rates as low as 9.95% APR" without stating the typical APR. The fine print notes that this rate is available to those who qualify with good credit.¹⁴¹

An Omni loan contract with a Virginia borrower from 2010 illustrates a typical loan.¹⁴² The \$559.07 five month installment loan had a disclosed 34.949% APR. The transaction included financed premiums for optional credit life (\$1.01) and credit disability insurance (\$9.09) plus a \$37.48 prepaid finance charge or processing fee that is non-refundable after 15 days even if the loan is prepaid in full. American Bankers Life Assurance Company of Florida provided credit life insurance and credit disability insurance.

While Omni recommends payment via allotment,¹⁴³ Omni payment options include by cash, check, money order or other lawful means; by Military Allotment (with statement that "I am not required to repay MY loan by Military Allotment and repaying by Military Allotment is not a condition for approval of this loan"); or payment by electronic funds transfer from an account at a depository institution. Allotments for Omni in 2010 were handled by Military Servco, Inc., located in New Rochelle, New York. The Allotment Disclosure Form states that the borrower can cancel the allotment and automatic disbursement of payments to Omni at any time and that the borrower is not obligated to pay any fee for the allotment or automatic disbursement.¹⁴⁴

2. **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 at stores, not online. Patriot is licensed by the states where it has stores. Patriot states that most of its loans are repaid by MAC allotment, but the lender also accepts payment via electronic funds transfer payments directly from the military borrower's bank account. Payment can also be made via TruePay and MoneyGram transactions.¹⁴⁵

¹⁴⁰ www.militaryloans.com/terms, visited 6/23/11.

¹⁴¹ Omni Financial, Brochure "Need Money For Something Important? Come To Omni and Let Us Help," on file with CFA.

¹⁴² Omni contract, on file with CFA, March 18, 2010.

¹⁴³ www.militaryloans.com/faq, visited 6/23/11.

¹⁴⁴ Omni Contract, dated 03/06/10, on file with CFA.

¹⁴⁵ www.patriotloanco.com/FAQS_main.htm, visited 7/6/11.

3. Pioneer Financial Services, Inc. (www.pioneermilitaryloans.com) is owned by Midcountry Financial Corp., a Georgia corporation, and purchases consumer loans and retail installment contracts for credit sold to servicemembers and career DoD retired military personnel or U.S. Department of Defense employees. The loans are purchased from Military Banking Division of MidCountry Bank, a federally chartered stock savings association, supervised by the Office of Comptroller of the Currency and wholly owned subsidiary of MidCountry Financial Corp. which originates loans at loan offices in 14 states and via the Internet.¹⁴⁶ Pioneer also provides sales financing to about 392 active retailers, including electronics, furniture, jewelry, travel, and auto accessory retailers.¹⁴⁷ Pioneer Services 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.

A Pioneer promotional mailing to military housing in the Hampton Roads area of Virginia in 2010 headlined "Give your budget a fighting chance." The offer was for personal loans up to \$10,000 with no collateral required, "competitive fixed rates and no hidden fees," "no-hassle application and approval process," and "quick access to your money." Despite the "no hidden fees" claim, the mailer included no information on interest rates or fees.¹⁴⁸

A Pioneer loan contract from Virginia states a 22.39 percent rate of interest and 35.10 per cent APR for a \$1,707.38 loan. With a finance charge of \$542.44, total payments over 18 months come to \$2,249.82. The amount financed includes \$112.43 for Debt Protection, \$94.95 for a "Military Savings Card," and \$349.45 for unspecified purpose to Pioneer. Borrowers also paid a \$168.86 loan origination fee to Pioneer.¹⁴⁹ Although the loan was made in Virginia to a servicemember stationed in Virginia, the contract states that the governing law is Nevada. Pioneer's website also lists Nevada as the choice of law that governs loans made via its website.¹⁵⁰

Pioneer sells a "Debt Protection Contract" with its loans in place of a credit insurance policy and lists this product as "optional" in the loan agreement. The "monthly protection amount" cannot exceed \$500 per month for the Original Life Protection Amount not to exceed \$20,000. For one contract from 2010 on file with CFA, the servicemember was charged \$145.30 in a single payment for an 18-month \$2461.81 obligation. In prior years, Pioneer Military Lending sold credit insurance products from American Bankers Life Assurance Company of Florida. For example, a 2007 loan contract, signed the day the Military Lending Act rules took effect, for a

¹⁴⁶ Pioneer Financial Services Inc., Form 10K, Securities and Exchange Commission, September 30, 2011, p. 1.

¹⁴⁷ Ibid, p. 3.

¹⁴⁸ Pioneer Services mailer, addressed to "Military Family" in Norfolk, VA, 2010, on file with CFA.

¹⁴⁹ Pioneer Services Contract, dated 8/18/2010, Virginia borrower, on file with CFA.

¹⁵⁰ www.pioneermilitaryloans.com/terms/termsofuse.cfm, visited 6/22/11.

\$2,000 loan included \$118.64 in insurance premiums for credit life and credit accident and sickness coverage.¹⁵¹

The payment options for Pioneer are via allotment with back up electronic funds transfer from the borrower's bank account, followed by electronic funds transfer (EFT), and allotment plus EFT. Allotment payments are handled by First Citizen's Bank/FirstNet in Kentucky with a \$2 fee per monthly payment.¹⁵² About 47 percent of Pioneer borrowers repay loans via the allotment system.¹⁵³ Since a portion of borrowers are retirees or civilian DoD employees, it is not clear what percentage of active-duty servicemember borrowers use allotments to pay this lender.

The "Pioneer Services Military Savings Card" costs \$94.95 annually and can be paid for via money order or added to the cost of the loan. This extra is an optional purchase. The Savings Card provides discount benefits at Legal Club of America® for Legal Services, AutoVantage® for Consumer Benefit Services, Access Development ® for Hotel & Dining Discounts, and Nation Safe Drivers ® for Roadside Assistance.¹⁵⁴ The Pioneer form states that New Benefits, Inc. is the provider of the products and services included and that MidCountry Bank accepts no liability or responsibility for the actions of the vendor or service providers.¹⁵⁵

For other military installment lenders, see CFA survey chart and findings below.

E. CFA Military Installment Loan Survey Summary

In 2011, CFA surveyed online installment loan offers to servicemembers and found nine lenders that deal primarily or exclusively with servicemembers. Most of these lenders make loans solely 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.

In conducting the survey, CFA executed a Google search using the terms "military loans apply." The surveyor collected the first 4 pages of search results and eliminated repeats, lead generators, and other non-lender websites to arrive at the sample.

The survey sample included 10 lenders of which nine deal primarily or exclusively with military service members (the exception being Springleaf Financial which does not market specifically to service members on their website). The survey includes two additional lenders that were not identified during the online search, Patriot Loan Co., which only offers in-person military loans,

¹⁵¹ Pioneer Military Lending contract, dated 10/1/2007, on file with CFA.

¹⁵² Pioneer Services Loan Repayment Election Form, loan dated 4/14/2010, on file with CFA.

¹⁵³ Pioneer Financial Services, Inc. 10-K filing, SEC, September 30, 2011, p. 8.

¹⁵⁴ Pioneer Services Military Savings Card: ELECTION FORM, on file with CFA.

¹⁵⁵ Ibid.

and World Acceptance Corporation, which only offers in-person loans to civilians and service members.

Seven of the twelve lenders make loans through the internet without having branch offices. CFA's survey of a sample of online military installment lenders found wide variation in state-by-state licensing of installment lenders. Among lenders with storefront branches, most are licensed in some of the states where they do business. Pioneer is the exception. As a federally-chartered bank, Pioneer is not licensed by state credit regulators.¹⁵⁶ Omni Financial was licensed in more than half the states in which they have branches.¹⁵⁷ The other storefront lenders were licensed in almost every state they do business in. A caveat is the difficulty of identifying licensees in all states, due to variations in the entity's name. The bottom line is that installment loan companies that serve the military are not universally licensed in every state where loans are made both via the Internet and from store locations.

¹⁵⁶ Pioneer Financial Services Inc. SEC Form 10-Q, "Management's Discussion and Analysis of Financial Condition and Results of Operations, Overview p. 1, <http://insurancenewsnet.com/print.aspx?id=342397&type=topnews>, viewed May 14, 2012.

¹⁵⁷ CFA review of state licensing websites for states listed on Omni website, conducted mid-2011.

CFA Survey of Online Military Installment Lenders

Company	URL	Main Office Location	Branch Locations	Claims of licensure	Confirmed licenses	Min/Max Loan	Min/Max Loan Term	APR	Fees
Pioneer Services	www.pioneerarmilitaryloans.com	Main office in Las Vegas, NV.	17 local offices in NC, CA, CO, GA, TX, TN, NY, KY, LA, KS, VA, OK, WA	No claim of licensure on website		\$500 to \$10,000	Up to 36 months	Not given	An origination fee is charged
Military Financial	www.militaryfinancial.com	Owned by British Virgin Islands company International Cash Advance, address is in Delaware (not on website)		No claim of licensure on website	DE	Up to 40% of take home pay	Typically 4-6 paydays	Not given	No application fees or maintenance fees
Just Military Loans (General Financial, Inc.)	www.justmilitaryloans.com	Wilmington, DE		No claim of licensure on website	DE	\$1,000 to \$3,000	Up to 12 monthly payments	Not given on site, 80.53% on loan cont.	Not given

Company	URL	Main Office Location	Branch Locations	Claims of licensure	Confirmed licenses	Min/Max Loan	Min/Max Loan Term	APR	Fees
Omni Financial	www.militaryloans.com	Main office in Las Vegas, NV. Storefront locations in 19 states.	branches in AZ, CA, CO, FL, GA, HI, KY,KS, LA, MO, NV, NC, NY, NM, OK, TN, TX, VA, WA	No claim of licensure on website	CA, CO, GA, FL, LA, NC, NY, NV, TN, TX, VA, WA	\$500 to \$10,000	6-36 months	9.95% - 34.95%	No application fees or maintenance fees
US Military Lending Corp	www.usmilitarylendingcorp.com	Las Vegas, Nevada		No claim of licensure on website		\$1,000 to \$2,500	12 months	Not given	No application fees
Armed Forces Loans	www.armedforcesloans.com	Las Vegas, Nevada		No claim of licensure on website	NV	\$500 to \$5,000	Up to 36 months	28.5% to 87.5%	No application fees
Military Funding USA, Inc.	www.loansmilitary.com	Not given		No claim of licensure on website	No loans to residents of CA, FL, GA, MT, NV, WV or states where military stationed are "residents"	\$1,000-\$3,000	12 months	Not given	Not given
Springleaf Finance, Inc.	www.springleaffinancial.com	P.O. Box 3662 Evansville, IN 47735-	More than 1,100 branches across 40	CA, NJ, NY, PA, VA	AL, AZ, CA, CO, GA, FL, HI, IL, LA, KY, KS, MO, NC, NJ, NY,	Q	Q	Q	Q

Company	URL	Main Office Location	Branch Locations	Claims of licensure	Confirmed licenses	Min/Max Loan	Min/Max Loan Term	APR	Fees
		3662	states		NV, OK, TN, TX, VA, WA				
Jones Finance, Inc.	www.rapidloans.com	Daleville, AL		No claim of licensure on website	AL	\$100 to \$3,000	Not given	Not given	Not given
Lexicon Lending Corporation	www.lexiconmilitaryloans.com	Fort Mill, SC		Licensed in KY, MO, SC, TX, VA.	KY, MO, TX, VA	\$500 to \$10,000	Not given	Not given	Origination fee is charged
World Acceptance Corporation	www.worldacceptance.com	Greenville, SC	GA, SC, TX, OK, LA, TN, MO, IL, NM, KY, AL, WI, and Mexico	GA, SC, TX, OK, LA, TN, MO, IL, NM, KY, AL, WI	AL, IL, LA, KY, MO, OK, TX, WI	Generally under \$4,000	Generally less than 36 months	Not given	Not given
Patriot Loan Co.	www.patriotloanco.com	Spartanburg, SC	CO, TN, NC, SC, GA, FL		GA, CO, NC, TN, FL	\$100 to \$1,000			

The surveyed installment lenders' loan amounts were varied but all were between \$100 and \$10,000. The repayment terms were 36 months or less. Military Financial offers the shortest loan-term of four to six paydays. Loan costs stated as APR's and fees are rarely disclosed. Omni gave an APR range of 9.95% to 34.95%, while Armed Forces loans gave an APR range of 28.5% to 87.5%. These rates may not include fees and insurance premiums. Extra fees are common. For example JustMilitaryLoans charges a \$10 wire transfer fee and a \$10 bank transfer fee for a loan, plus a Loan Origination Fee in the amount of 40 percent of the loan amount which is paid in twelve equal monthly installments.¹⁵⁸

¹⁵⁸ Installment Loan Agreement, Just Military Loans/General Financial, Inc., signed June 28, 2011, on file with CFA.

All lenders that disclose payment methods offer payment via allotments. Some offer other methods as well. Some lenders recommended or preferred allotment and it seems to be the most used payment method. For example, Armed Forces Loans FAQs states “By convenient allotments” as the answer to “How do I make my payments to you?”¹⁵⁹

Half of the lenders have a choice of law provision that states that loan agreements are governed by the states where their main offices are located. Military Financial claims to be subject to the laws of the British Virgin Islands and that its loans are not subject to Military Lending Act protections since the loans are structured as “open-end” credit.¹⁶⁰

F. Enforcement Actions and Complaints

At least one state has brought an enforcement action since passage of the Military Lending Act to require an online military installment lender to comply with its state credit laws. Nevada credit regulators filed a consent order in late 2008 against American Military Funding Inc., dba www.americanmilitaryloans.com; Military Funding USA, Inc. aka, World Wide Military Funding, Inc. dba www.loansmilitary.com to settle a cease and desist order citing unlicensed lending.¹⁶¹ In the consent order, Military Funding USA, Inc. agreed to pay a \$50,000 administrative assessment to the Division of Financial Institutions for alleged unlicensed activity in Nevada; agreed to dissolve American Military Funding, Inc.; and Military Funding USA Inc. agreed to become licensed in Nevada.¹⁶² This company is not identified on the Nevada licensee list and its loan application at www.loansmilitary.com currently states that loans are not available 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.”¹⁶³

CFA asked the Better Business Bureau Military Line staff if the online installment lenders in the survey had triggered complaints. The BBB searched their database of over 40,000 complaints received over the first three quarters of 2011 involving a wide variety of products and services and found 37 complaints filed against the online military installment lenders listed in the CFA survey. Of those complaints, four were filed by military retirees and two came from DoD civilian employees. Almost 70 percent of complaints were filed by Army personnel. At least one complaint was filed naming seven of the lenders in our sample. One company, Pioneer Military Lending, accounted for nearly 70 percent of the complaints filed naming an online military installment lender. The BBB notes that complaints don’t necessarily signify that a

¹⁵⁹ www.armedforcesloans.com/QuestionAnswers.aspx, visited 8/2/11

¹⁶⁰ <https://www.militaryfinancial.com/Faq.aspx>, visited 1/11/12

¹⁶¹ “Nevada lender’s legal trouble shows perils of Internet loans,” Navy Times, October 20, 2008, www.navytimes.com/money/financialadvice/military_sgtshopper_090808w/ viewed July 11, 2011.

¹⁶² Consent Order, In the Matter of American Military Funding Inc, dba www.americanmilitaryloans.com; Military Funding USA, Inc aka, World Wide Military Funding, Inc. dba www.loansmilitary.com, Nevada Financial Institutions Division, Appeal No. 55630-NR/55629-PL and 55631-NR/55628-PL, December 29, 2008.

¹⁶³ https://secure.netsolhost.com/loansmilitary.com/loan_application_secure.php, visited 1/10/12.

business is conducting transactions unfairly and that the larger the business, the more likely it is that at least some complaints will be filed. It is not clear whether the high proportion of complaints filed against this one lender is a result of Pioneer's share of the market or due to practices by the lender. In the future the BBB will be able to report more information about the issues raised in complaints filed.¹⁶⁴

¹⁶⁴ BBB Military Line data on complaints filed against CFA sample of military installment lenders, electronic communication from Stu Carroll, BBB Military Line, December 1, 2011. On file with CFA.

IX. No Impact on State Regulation of Lending to Non-Resident Borrowers

State Enforcement of Small Loan Laws

Servicemembers are not always protected by state credit laws, specifically small loan regulations and rate caps. 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 not been licensed or supervised by those states. Servicemembers who list their home state on Leave and Earnings Statements are not considered “residents” of the state in which they are stationed by some lenders. As a result, state small loan rate caps, disclosure requirements, and other protections were denied to servicemembers stationed in those states.¹⁶⁵

This issue was raised in the 2006 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.”¹⁶⁶ The Military Lending Act appeared to correct the jurisdiction problem identified by the DoD Report to Congress by prohibiting discrimination against nonresident borrowers under state law. The Preemption section of the MLA states:

(2) Different treatment under State law of members and dependents prohibited. States shall not –

(A) authorize creditors to charge covered members and their dependents annual percentage rates of interest for loans higher than the legal limit for resident of the State; or

*(B) permit violation or waiver of any State consumer lending protections for the benefit of residents of the State on the basis of nonresident or military status of a covered member or dependent of such a member, regardless of the member’s or dependent’s domicile or permanent home of record.*¹⁶⁷

The DoD rules implementing the MLA simply repeat the text of the law without further clarification of how it is to be applied.¹⁶⁸ It is our understanding that the Department views the non-resident discrimination provision as only applying to products defined as consumer credit, but CFA has not seen any document in support of that reading of the law.

¹⁶⁵ Department of Defense, “Report on Predatory Lending Practices Directed at Members of the Armed Forces and Their Dependents,” August 9, 2006, p. 17 and 18.

¹⁶⁶ Department of Defense, “Report on Predatory Lending Practices Directed at members of the Armed Forces and Their Dependents,” August 9, 2006, p. 17-19.

¹⁶⁷ 10 U.S.C. §987 (d)(2).

¹⁶⁸ 32 C.F.R. Part 232.7 Preemption (b) “Different treatment under State law of covered borrowers is prohibited. States may not: (1) Authorize creditors to charge covered borrowers rates of interest that are higher than the legal limit for residents of the State, or (2) Permit the violation or waiver of any State consumer lending protection that is for the benefit of residents of the State on the basis of the covered borrower’s nonresident or military status, regardless of the covered borrower’s domicile or permanent home of record, provided that the protection would otherwise apply to the covered borrower.”

As a result, there is confusion about whether the anti-non-resident provision only applies to “consumer credit” products defined by DoD which currently are payday, car title and tax refund anticipation loans, or whether this provision applies to “covered borrowers,” regardless of the type of credit as long as the loan is not excluded from coverage by the Military Lending Act (i.e., mortgages and auto purchase loans.) CFA’s fact sheet on MLA protections posted at the time the regulations took effect in 2007 used the DoD interpretation that the non-resident protection applied only to defined “consumer credit.” The plain text of the law, however, does not contain that limitation on coverage.

When the Department of Defense reported to the Senate Armed Services Committee in 2008 on implementation of their MLA rules, the Department noted that installment lenders “are licensed in the United States and storefront non-depository finance companies fall under the jurisdiction of the states in which the Service member is assigned.”¹⁶⁹ Since this report was discussing a form of credit not defined as “consumer credit” for purposes of the MLA, it is unclear whether by 2008 the Department interpreted the non-discrimination provision of the MLA as applying broadly to covered borrowers, not limited to covered credit extended to covered borrowers. In any case, CFA believes that the law should be broadly interpreted to achieve Congressional intent and that the non-discrimination provision should empower states to enforce their laws with lenders that target servicemembers stationed in their states, regardless of the residency listed for borrowers.

In 2011 CFA surveyed state credit regulators to ask about compliance with the MLA including lender compliance with state licensing requirements and protections when loans are made to non-resident servicemembers stationed in their states. Of the fifteen state credit regulators that responded, three state regulators (IN, MO, MT) replied that military installment lenders are not required to be licensed by or subject to state law when making loans to non-state residents stationed at bases in their states. The Texas regulator noted conflicting legal interpretations and stated that two military installment lenders had outlets in Texas but only one of the lenders, Omni, chose to be licensed and supervised by the Texas Office of Credit Commissioner.¹⁷⁰

In CFA’s survey of military installment lenders, we found that not all military installment lenders were licensed in each state in which they had offices or in all states where loans were made via the Internet.

Recommendation: Congress should clarify that the MLA requirement for equal treatment of non-resident military borrowers by states applies to all forms of credit regulated at the state level. The Department of Defense should issue a clear directive to state credit regulators and attorneys general interpreting the plain language of the Military Lending Act as requiring states to license and supervise lenders that make loans to non-resident servicemembers in their states for all forms

¹⁶⁹ Department of Defense, “Report on Implementation of Limitations on Terms of Consumer Credit Extended to Service Members and Dependents,” July 22, 2008, p. 28.

¹⁷⁰ State credit regulator survey responses on file with CFA.

of credit not excluded by the Military Lending Act (mortgages and auto finance loans.) If necessary, DoD should request that states amend their credit laws to apply to non-residents that obtain credit in their state, thereby explicitly complying with the federal law.

X. No Impact on Retail Installment Sales Credit or Rent to Own

The Department of Defense rules applying the Military Lending Act do not define rent-to-own or financing to buy products and services as “consumer credit” subject to the protections of the law, notably the provision prohibiting credit secured by allotment or the 36 percent APR inclusive rate cap. However, the targeting of servicemembers by retailers, car dealers, and other entities that sell on credit paid by allotment, is legendary. A recent expose described the plethora of lenders outside the gates at Fort Sill in Oklahoma, including “military loan” brokers, pawn shops, furniture stores, electronics dealers, and car stereo dealers that offer “a tantalizing array of buy now-pay later options, marketed in particular to young soldiers who have little in the way of savings and either bad or non-existent credit histories.”¹⁷¹

Financial counselors reported to CFA that retailers clustered around the gates to large bases extend easy credit for discretionary purchases, paid for by allotment, which can leave military families short of funds to pay for essentials. An Army financial readiness specialist told *Army Times* about an E-3 soldier who owed \$630 a month for furniture, at least one-third of his monthly basic pay.¹⁷² Counselors who met with CFA described financial stress caused by easy financing of big-ticket items, paid by allotment, at retailers that specialize in credit sales to servicemembers.

At a forum at Fort Bragg, NC, concern was expressed that young and inexperienced servicemembers “are lured by local and online businesses into buying expensive appliances, electronics, furniture and other items with high interest, high fee loans.”¹⁷³ Frequently these extensions of credit are paid via allotments, the wage assignment payment service provided by Defense Finance and Accounting Service (DFAS). Military loan companies provide retail installment sales financing for retailers such as Best Buy. Omni financing is provided via Internet access from the retailer and Omni strongly recommends payment via allotment.¹⁷⁴ Sales finance offers by the large military lenders are structured as closed-end credit but are unsecured and for longer terms than the defined payday and car title loan products subject to MLA protections. As a result, none of the protections of the Military Lending Act apply to this form of military lending. While terms for sales financing repaid by allotment vary by lender and retailer, the SmartBuy example illustrates problems encountered by servicemembers under the current program.

Britlee, Inc. outlets sold electronics in locations adjacent to military bases under the names SmartBuy, The Military Zone, and Laptoyz Computers and Electronics. Financing was provided by Millennium Finance Inc. and Integrity Financial, Inc. as well as Rome Finance, all with ownership connections to SmartBuy.¹⁷⁵ SmartBuy sales personnel at retail outlets near military bases targeted the sale of computers, electronic consumer goods and financing to active duty military at greatly inflated prices and with excessive and usurious financing arrangements,

¹⁷¹ Chris Kirkham, “At Fort Sill, High-Interest Lenders Circle the Gates,” *Huffington Post*, Jan. 24, 2011

¹⁷² Karen Jowers, “Consumer Watch: Personal finance specialists offer free counseling to troops,” *Army Times*, March 22, 2010.

¹⁷³ Paul Woolverton, “Military Leaders Oppose Lender Legislation,” *Fayetteville Observer*, May 7, 2011.

¹⁷⁴ www.militaryloans.com/faq, visited 9/27/11.

¹⁷⁵ Complaint, *New York v. Frisco marketing of MY LLC, et al.*, File 2010-00001385, (Supreme Court State of New York, County of Jefferson June 13, 2011), pages 4-5.

according to the complaint filed by the New York Attorney General.¹⁷⁶ The prices of merchandise was marked up over 200 percent above retail prices to hide hidden financing costs for products obtained at retail from CostCo Inc., Sam's Club, and WalMart. New York officials calculated that the effective interest rate that lenders received from the sale of merchandise at the SmartBuy store in Watertown, NY exceeded 244 percent when the portion of the inflated sale price the lender received was added to the state interest payments.¹⁷⁷ The Tennessee Attorney General filed a complaint against SmartBuy entities and alleged that some soldiers were told that payment by allotment was required and that an undisclosed \$3 monthly allotment payment fee was added to the amount deducted from their pay. SmartBuy used the allotment service of First Citizens Bank in Kentucky, required soldiers to sign an authorization giving the sales representative the power to change the password on the soldier's MyPay account.¹⁷⁸

One example illustrates how inflated prices at SmartBuy obscured the true cost of financing a purchase. A young Marine bought an iPad at the SmartBuy in Jacksonville, NC which was financed at 11.76 percent APR with a payment of \$173 per month for twenty one months, totaling \$3,600 or five times the price at a military exchange.¹⁷⁹

Besides being sued by Attorneys General in New York and Tennessee, the company's outlets were placed off-limits to troops by installation commanders at Fort Sill and Altus Air Force Base in Oklahoma, Fort Bragg in North Carolina and Fort Hood in Texas.¹⁸⁰ The New York case resulted in a \$3.5 million settlement against Rome Finance Co., Inc. an unlicensed lender for SmartBuy. The Tennessee Attorney General won a \$10.8 million judgment against Rome Finance and Britlee Inc. in 2009.¹⁸¹ There is no record that the Department of Defense allotment system was aware of the abuses or took steps to intervene on behalf of troops.

Other retailers locate exclusively near military bases, such as USA Discounters, Harris Jewelry, and Freedom Furniture and Electronics, and heavily promote credit sales to a military market. For example, USA Discounters, which sells furniture, electronics, automotive accessories, computers, appliances, and bedding, and/or its Fletcher's Jewelers outlets have store locations near bases in California, Colorado, Florida, Georgia, Kansas, Louisiana, Maryland, North Carolina, Oklahoma, Tennessee, Texas, Virginia with stores coming soon to Washington, DC and Washington state.¹⁸²

USA Discounters promotes that 'For Military and Government Employees, Automatic Credit Approval.' Bold banners tout "No Credit? No Problem! Need Credit?" Payment methods include via allotment, electronic funds transfer from bank accounts, and by credit cards as well as in-person payment at stores or by mail.¹⁸³ Store personnel assist military buyers to set up allotments.

¹⁷⁶ *Id.* At 6.

¹⁷⁷ *Id.* At 8.

¹⁷⁸ Complaint, State of Tennessee, v. BRITLEE, INC., et al., 2007 WL 6955109 (M.D. Tenn.) at 9.

¹⁷⁹ Karen Jowers, "Military Buyers Beware," *Army Times*, February 14, 2011.

¹⁸⁰ Karen Jowers, "Attorneys general: Company defrauded service members," *Army Times*, June 1, 2010.

¹⁸¹ Press Release, "Federal and State Officials Announce New Law Enforcement Partnership to Protect Military Community," Consumer Financial Protection Bureau, January 25, 2012.

¹⁸² www.usadiscounters.net/StoreLocations.aspx, viewed March 27, 2012.

¹⁸³ www.usadiscounters.net/CustomerPaymentPlans.aspx, viewed March 27, 2012.

Complaints posted on complaint websites typically claim that products are over-priced and that extras are expensive. For example, a consumer complained that USA Discounters priced a Nintendo Wii video game system at \$500 while the price elsewhere was \$199.¹⁸⁴ A Compaq Presario computer sold at USA Discounter for around \$3,000 but cost \$458 at Office Depot, according to another complaint.¹⁸⁵ USA Discounters charged \$250 for credit protection and \$262 for an extended warranty, according to a consumer who noted “Beware of their antics – low 5.99% simple interest (true) but they superinflate their prices.” In that complaint, the store is said to charge \$2,399 to \$2,599 for a Sony Vaio computer that goes for \$699 on Amazon.¹⁸⁶

USA Discounters advertises the twice monthly payment for products, not the cash price. For example, the March specials flyer posted on its website lists a four-piece bedroom set at \$33 twice monthly, a “March Slam Dunk Special Buy” 55 inch LCD HD TV at \$39 twice monthly, and gaming systems starting at \$9 twice monthly. The asterisks beside these twice-monthly payments connect to fine print at the bottom of the page where consumers are told to multiply the payment amount by 48 to get the total price which does not include taxes and any delivery and installation charges.¹⁸⁷

Another retailer, Freedom Furniture & Electronics, sells via a website and locates its stores near military bases. Military customers will find Freedom stores near large military bases at Norfolk, VA, Newport News, VA (near Ft. Eustis), Hinesville, GA, Colorado Springs, CO, Oak Grove, KY (Fort Campbell); Fayetteville, NC (Ft. Bragg); Jacksonville, NC (Camp Lejeune); Oceanside, CA (Camp Pendleton); National City, CA (San Diego Naval Base); Killeen, TX (Fort Hood); El Paso, TX; and opening soon in Lawton, OK, Columbus, GA, and Lakewood, WA.

An ad from San Diego says “Freedom Finances All Military & Government Employees 100% Approval” and advertises its wares by also only displaying the twice-monthly payment amount, not the cash sale price.¹⁸⁸ For example, an Apple iPad 32 GB with WIFI is listed as costing “Only \$35 per Payday.” The fine print on the back of the circular explains that you must multiply the per-payday payment times 48 (two years of bi-monthly payments) to arrive at the total price paid. The iPad costs a total of \$1,680 under this financing while the same tablet computer listed for \$599 at www.apple.com, as of October 26, 2011.

Freedom’s online support staff state that payment by allotment is “what we prefer” and allotments are processed by First Citizens Bank in Kentucky.¹⁸⁹ Financing is offered via Freedom Acceptance Corporation.¹⁹⁰ Complete text of the Freedom Furniture & Electronics small print spells out the financing arrangements:

Freedom offers 6 months 0.0% interest with credit approval. If the account is kept current and the entire balance is paid in full within 180 days of receipt of merchandise purchased, all finance charges will be rebated to customer. Per-payday or twice-monthly payments quoted are based

¹⁸⁴ <http://usa-discounters.pissedconsumer.com/usa-discounters-buyer-beward-20100526183549.html>

¹⁸⁵ <http://usa-discounters.pissedconsumer.com/over-charges-for-items-20080611123816.html>

¹⁸⁶ www.ripoffreport.co/loans/usa-discounters/usa-discounters-beware-disc-4cce7.htm

¹⁸⁷ USA Discounters March Specials, viewed at www.usadiscounters.com March 27, 2012, on file with CFA.

¹⁸⁸ Freedom Furniture & Electronics circular. September 2011, obtained at San Diego Naval Base, on file with CFA.

¹⁸⁹ CFA online chat with Freedom Stores October 26, 2011, on file.

¹⁹⁰ https://www.credit4military.com/facweb/KWC_START.pgm?clid=FAC&task=privacy, visited Oct. 26, 2011.

*on 24 months with zero down payment at 19.96% APR on Approved Credit, taxes not included. To calculate the total cost of financing simply multiply the payment amounts by 48. Payment amounts quoted include optional ancillary protection products. Freedom's other credit plans begin at 14.99% APR O.A.C. Some plans may require a down payment. Regardless of your credit, Freedom has a plan for everyone!"*¹⁹¹

Another retailer that specializes in credit sales to the military is Harris Jewelry which claims twenty-one locations in the United States, typically near military bases, such as Oceanside, CA near Camp Pendleton, Pensacola, FL near Naval bases, Fayetteville and Jacksonville, NC, and Killeen, TX where Fort Hood is located.¹⁹² Ads for engagement rings post both the payment per payday and a cash price. For example, a 10KT white gold engagement ring is listed at \$27 per payday or \$799.¹⁹³ Payments are handled via allotment through MAC/Fort Knox Bank and MYPAY, and allotments can be initiated online or at the store. Payment can also be made using debit and credit cards or checks or through Western Union Quick Collect.¹⁹⁴

Rent-to-Own Not Defined as Covered Consumer Credit

Despite the DoD Report to Congress inclusion of rent-to-own as one of the forms of financing causing problems for servicemembers, the first set of regulations defining covered credit did not include rent-to-own transactions. The problems noted in the 2006 Report included extending credit to servicemembers without regard for the borrower's ability to repay and excessive fees and interest. As the Department explained when MLA rules were issued, "Rent-to-own, which is not covered as credit under the Truth-in-Lending Act (TILA), can represent an expensive alternative to credit when used as a means of purchasing an item. DoD explained that because rent to own provide rental opportunities as well as options for ownership which are not loans under TILA, these products and services were not covered by the definition of "consumer credit."¹⁹⁵ The final rule excluded any credit product not subject to the Truth in Lending Act, which included rent to own as well as overdraft loans.

Rent-to-own stores are located in military towns. For example there are ten Rent-A-Center stores in and around Jacksonville, Florida, and six in Norfolk and Virginia Beach, Virginia, home to Navy bases. In Killeen, Texas, home to Fort Hood, there are three Rent-a-Center stores. The Better Business Bureau says that none of the 450 Rent-A-Center stores are BBB accredited, while 837 complaints were listed on the BBB website from the last three years. Of those complaints, over six hundred were problems with products and service while 119 were billing and collection issues.¹⁹⁶

¹⁹¹ Freedom Furniture & Electronics sales flyer, obtained San Diego, CA September 30, 2011, on file with CFA.

¹⁹² www.harrisjewelry.com/screen-HJ-STORES.html, viewed March 27, 2012.

¹⁹³ www.harrisjewelry.com/c-HJ-ER.html, viewed March 27, 2012.

¹⁹⁴ www.harrisjewelry.com/screen-HJ-ONPAY.html, viewed March 27, 2012.

¹⁹⁵ 32 CFR Part 232, Limitations on Terms of Consumer Credit Extended to Service Members and Dependents; Final Rule, p. 8-9.

¹⁹⁶ CFA memo, "Rent-A-Center Profile," based on Better Business Bureau data. On file with CFA.

CFA consultants' visits to military bases for this project found rent to own stores located near the gates to bases. At Fort Leonard Wood, one RTO outlet until recently only accepted payments via allotment from military pay. A financial counselor at that base reported that the majority of servicemembers coming in for financial aid or counseling had expensive rent-to-own contracts. One soldier earning less than \$1,000 per month was paying nearly \$500 in RTO bills for furniture. A recent study by a consumer organization in Maryland found that rent-to-own stores target low- and moderate-income families with total prices two to three and a half times what traditional retailers charge for the same merchandise and noted interest rates ranging from 65 to more than 300 percent. The Maryland data found that families pay more than \$1,000 more for refrigerators and televisions at rent-to-own stores than they would pay for the same goods at traditional retailers.¹⁹⁷

Recommendation: The Department of Defense should initiate a new round of rule-making under the Military Lending Act and add rent-to-own and retail installment financing as defined "consumer credit" to receive protections provided in the law, notably the prohibition against mandatory payment via allotment.

¹⁹⁷ Marceline White and Franz Schneiderman, "Rent to own: Profiting from the Poor," A Report from the Maryland Consumer Rights Coalition, February 2012.

XI. Enforcement Tools for Military Lending Act Must be Strengthened

In order to provide the protections intended by Congress and needed to safeguard servicemembers and their families, the enforcement tools at the federal and state level must be improved.

A. Federal Enforcement

The Military Lending Act,¹⁹⁸ adopted in 2006, provided for regulations to be written by the Department of Defense but did not specify enforcement or supervision authority.

Violation of the Military Lending Act (MLA) is a misdemeanor, with violators to be fined as provided in title 18, or up to one year imprisonment, or both. No civil penalties are specified. Other remedies are preserved and a person claiming relief can be awarded consequential and punitive damages. Contracts that violate the law are void from inception, meaning that the lender cannot collect principal or interest. Mandatory arbitration clauses are prohibited.¹⁹⁹

The preface to the regulations issued by the Secretary of Defense in 2007²⁰⁰ discussed the Department's expectation of enforcement by federal banking regulators and state credit officials. "The Department understands that the federal bank, thrift and credit union regulatory agencies have authority—derived from federal law unique to federally-regulated depository institutions—to enforce these rules with respect to the institutions that they supervise."²⁰¹

Since a refund anticipation loan was the only credit product made by banks and covered by the DoD MLA rules, CFA asked the two federal regulatory agencies overseeing banks that made these loans whether the MLA was enforced. The Office of Comptroller of the Currency incorporated the MLA rules into the OCC supervisory manual.²⁰² There were no formal enforcement actions. The FDIC's Consumer Compliance Examination Manual includes an examination program for each institution's military lending activities, regardless of the type of covered loan.²⁰³ The FDIC noted MLA violations in 71 compliance examinations out of approximately 8,500 compliance examinations conducted since 2007 and found that two banks extended RALs without first providing the required "Covered Borrower Identification Statement" to the applicant/borrower, making it less likely that the banks could know whether these two borrowers were covered service members.²⁰⁴

¹⁹⁸ 10 U.S.C. 987

¹⁹⁹ 10 U.S.C. 987(f)

²⁰⁰ 32 CFR Part 232 "limitations on Terms of Consumer Credit Extended to Service members and Dependents; Final Rule.

²⁰¹ 32 CFR Part 232.9 Penalties and remedies, p. 31 of 45.

²⁰² Office of Comptroller of the Currency, "Comptroller's Handbook: Other Consumer Protection Laws and Regulations," August 2009, available at www.occ.gov/publications/publications-by-type/comptrollers-handbook/other.pdf, p. 149-153.

²⁰³ "FDIC Complaint Manual ---June 2009, V-12.1 FFIEC Interagency Examination Procedures for 32 C.F.R. Part 232, Limitations on Terms of Consumer Credit Extended to Service Members and Dependents, viewed at www.fdic.gov/regulations/compliance/manual/pdf/V-12.1.pdf

²⁰⁴ Electronic communication with FDIC, on file with CFA.

Consumer Financial Protection Bureau

The Consumer Financial Protection Bureau did not exist when the Military Lending Act was enacted and is not included in the list of federal financial regulatory agencies to be consulted in the development of rules by the Secretary of Defense. In addition, the Military Lending Act was not on the list of federal credit laws that were transferred to CFPB when it opened for business July 21, 2011. As a result, CFPB does not have supervision and enforcement authority for the Military Lending Act. CFPB's Examination Procedures for Short-Term, Small-Dollar Lending, issued in 2012, requires examiners to assess application risks to consumers caused by violations of or the absence of compliance policies and procedures with respect to the Military Lending Act. In those cases, examiners can only identify violations of the MLA for referral to federal or state regulators "or other appropriate action."²⁰⁵ Presumably, the referrals will go to the larger banks' prudential regulators, including the Office of Comptroller of the Currency, the Federal Reserve, and the Federal Deposit Insurance Corporation, as well as to state credit regulators and enforcers. However, the new federal agency assigned the task of enforcing federal consumer protection laws in the credit and payments market does not have authority to directly enforce the protections of the Military Lending Act with bank and non-bank providers.

The Dodd Frank Act requires the CFPB to have an Office of Servicemember Affairs to represent the interests of military families within CFPB and to educate and empower military consumers. Hollister K. Petraeus was named head of this new office. Before it even opened for business, the CFPB and the Judge Advocate Generals of the Army, Marine Corps, Navy, Air Force, and Coast Guard signed an agreement on a Joint Statement of Principles to work together on protecting servicemembers and their families in the financial services market. The CFPB Office of Servicemember Affairs and the Offices of the Judge Advocate Generals announced formation of a formal working group to coordinate response to unlawful conduct targeted at military families.²⁰⁶ Early in 2012, CFPB, state attorneys general, U.S. attorneys and judge advocates from the five branches of the military created a database of financial companies that have been cited for abuse of military personnel. The Repeat Offenders Against Military database, which is only available to state and federal officials, will include information about completed civil and criminal legal actions against companies and individuals who are repeat offenders with servicemembers.²⁰⁷

There is a glaring gap in the enforcement authority of federal agencies under the Military Lending Act. While prudential regulators can enforce any law with the banks they supervise, the CFPB is not empowered to enforce the MLA and DoD rules with the large banks and non-bank lenders it supervises. The CFPB will feed complaints into the FTC's Military Sentinel, share information about repeat offenders in the ROAM database, but cannot bring actions against any entity that violates the Military Lending Act. However, the Federal Trade Commission does not have authority to enforce the Military Lending Act, either. As a result, the two federal agencies

²⁰⁵ Consumer Financial Protection Bureau, "Examination Procedures: Short-Term, Small-Dollar Lending," Module 2: Application and Origination, Other Risks to Consumers, at 11.

²⁰⁶ Press Release, U.S. Treasury Department, "Consumer Financial Protection Bureau and Military's Top Uniformed lawyers Release Joint Statement of Principles," July 6, 2011.

²⁰⁷ Kate Davidson, "Feds, State AGs to Track Military Financial Scams," American Banker, January 25, 2012.

responsible for enforcing federal law with non-bank financial providers are not authorized to enforce the Military Lending Act when they find violations.

Recommendation: As the CFPB collects complaints and information to document current abuses in the credit market that impact servicemembers, it should report to DoD those abuses and products that specifically target servicemembers that could be curbed by defining the product as “covered credit” per MLA.

Recommendation: The Secretary of Defense and the CFPB should negotiate an agreement whereby CFPB provides enforcement support under the Military Lending Act. The MLA should be amended to add CFPB to the list of federal financial regulatory agencies to be consulted in the development of regulations and to explicitly provide CFPB enforcement authority under the MLA with any bank or non-bank financial service provider under its jurisdiction.

Recommendation: Congress should amend the Military Lending Act to authorize all federal regulators to enforce this protection, including the CFPB and the FTC.

B. State Enforcement²⁰⁸

The Department of Defense (DOD) issued implementing regulations that specifically defined payday loans, refund anticipation loans (RALs), and auto title loans as consumer credit covered by the MLA.²⁰⁹ Two of those non-bank products – payday and car title loans -- are subject to state licensing and supervision. According to comments published in the Federal Register with the final rule, the DOD intended to rely on both state and federal regulators for enforcement, with each agency being responsible for monitoring all creditors under their jurisdiction.²¹⁰ The DOD understood that federal bank, thrift, and credit union regulators would have authority to enforce the rules for the institutions that they supervise, but that their authority would be limited to narrowly defined depository institutions.²¹¹

²⁰⁸ State enforcement section prepared by James Christopher Matthews, legal researcher for Consumer Federation of America. Additional content and survey of state regulators written by Jean Ann Fox, director of financial services, CFA.

²⁰⁹ Limitations on Terms of Consumer Credit Extended to Service Members, 32 C.F.R. §232 (2006). The regulation defines consumer credit as: “[C]losed-end credit offered or extended to a covered borrower primarily for personal, family or household purposes...” The definition explicitly includes: 1) Payday loans, which are defined as: “Closed-end credit with a term of 91 days or fewer in which the amount financed does not exceed \$2,000...”; 2) Vehicle Title Loans, which are defined as: “Closed-end credit with a term of 181 days or fewer that is secured by the title to a motor vehicle, that has been registered for use on public roads and owned by a covered borrower, other than a purchase money transaction...”; and 3) Tax Refund Anticipation Loans, which are defined as: “Closed-end credit in which the covered borrower expressly grants the creditor the right to receive all or part of the borrower's income tax refund or expressly agrees to repay the loan with the proceeds of the borrower's refund.” The regulation exempts all credit that is not “consumer credit” from the scope of the MLA.

²¹⁰ “The Department [of Defense] does not view the regulation as having substantial direct effects on States, or distribution of power and authority. States determine whether they will enforce the regulation or not for creditors under their jurisdiction. Associations of state supervisors recommended the Department seek written agreements between the Department and state regulatory agencies about enforcement, supervision, and information sharing to help state authorities enforce those areas that will normally fall under their jurisdiction. The Department intends to rely on federal and state regulators to oversee or enforce compliance with the final rule, to the extent possible under their statutory authority, for their respective creditors.” 72 Fed. Reg. 50590 (August 31, 2007)

²¹¹ Id.

The DOD recognized that enforcement for non-bank lenders, who would be most likely to provide the types of credit covered by the regulation, would depend on state regulatory agencies.²¹² After the regulation went into effect, the DOD began to pursue Memoranda of Understanding (MOUs) with state and federal regulators to promote the sharing of information and to define MLA enforcement relationships.²¹³ In order to expand oversight opportunities, the Department changed its approach and now encourages all parties concerned, including state regulators, U.S. Attorneys, and the state Attorneys General, to use the Federal Trade Commission's Military Sentinel, a secure database of complaints available only to law enforcement agencies. Currently twenty-five state credit administrators are reported to have signed the FTC MOU for Military Sentinel.²¹⁴ The Consumer Financial Protection Bureau signed an agreement with the Federal Trade Commission in August 2011 to access consumer complaints in the FTC's Consumer Sentinel system and began sharing complaints the Bureau receives with Consumer Sentinel in early 2012.²¹⁵ By having all agencies report complaints regarding abusive financial products and practices to the Military Sentinel, information will be available to any agency that is empowered to bring enforcement actions against any covered lender.

As a result of the fragmented enforcement authority under the law, MLA enforcement remains less coordinated than the regime originally envisioned by the DOD. The details of enforcement vary greatly according to the type of consumer credit being regulated, the authority of each state regulator, and the language of applicable state statutes.

C. CFA Survey of State Credit Regulators

CFA surveyed the fifty state regulators of non-bank consumer credit to learn about state enforcement of the MLA and implementing regulations, state legislation adopted to confer authority to enforce the MLA as a matter of state law, and to ask about compliance by licensed lenders.²¹⁶ Fifteen states responded to the survey.²¹⁷ Four responding states enacted legislation to authorize the state to enforce the MLA (CA, IN, MT, TX) and Hawaii is considering legislation in 2012. In some cases state laws provide more protection than the MLA and those states, such as Vermont and Pennsylvania, had no need to add MLA enforcement authority. Four states responded that violation of federal law by a state-licensed lender is not considered a violation for state enforcement purposes; however, most of the survey respondents enforce the Military Lending Act with their licensees. Three of the four states responding either do not authorize payday and/or car title lending or the loan terms under state law fall outside the DoD definitions of covered credit, such as Colorado's payday loans with a minimum six month term.

²¹² "The Department is concerned that reliance solely on private litigation or criminal prosecution with respect to these other creditors may be insufficient to ensure uniform compliance with these rules with respect to all creditors. The Department understands that the consumer credit covered in the regulation is primarily overseen by state regulatory agencies." *Id.*

²¹³ DEPT. OF DEFENSE, REPORT ON IMPLEMENTATION OF LIMITATIONS ON TERMS OF CONSUMER CREDIT EXTENDED TO SERVICE MEMBERS AND DEPENDANTS (2008) at 22-25. See Appendix 2 for the text of a model Memorandum of Understanding.

²¹⁴ Electronic communications with Department of Defense, on file with CFA.

²¹⁵ Santaj Alag, CFPB Blog, "Consumer response now sharing complaints with FTC Consumer Sentinel," Match 14, 2012. www.consumerfinance.gov

²¹⁶ Survey responses on file with CFA.

²¹⁷ AL, CA, CO, ID, IN, ME, MO, MT, ND, OR, PA, SD, TX, VT, and UT.

The state regulator survey asked how examiners test for compliance with the MLA. Generally, state officials verify that lenders include the DoD regulatory application form that asks if borrowers are active-duty military or dependents. Examiners routinely check a sample of borrower files for documentation and identification of the borrower in Alabama, for example. California also samples loans to determine if loans made to covered borrowers comply with the 36 percent MAPR cap. Colorado looks for the borrower's pay stub in the loan file to verify that the borrower is not a servicemember for refund anticipation loans. Idaho looks for evidence of the sources of income that indicate the borrower is in the military.

Only two of the fifteen states responding would report any violations to the Department of Defense. Four state regulators reported that violations of the MLA had been detected and reported in examination reports. Only California has brought an enforcement action for violating the MLA, noting that one cease and desist order had been issued. In Texas, it is too soon to detect violations, since the Texas Consumer Credit Commissioner only obtained supervision authority over credit services business payday and car title lenders in 2012. Colorado Attorney General credit regulatory data collection has found no payday loans made to active-duty personnel or dependents, but does note that military retirees are getting payday loans.

If the states that responded to CFA's survey are representative, it appears that state credit regulators routinely inspect licensees for compliance with the DoD loan application disclosure form and test borrower files to determine if loans are being made to covered borrowers. While some violations have been noted, these have been corrected through supervisory action and have not resulted in law enforcement action or reporting to the Department of Defense.

Specific provisions of state law are covered in more detail below.

D. State Authority to Enforce Federal Laws

The following survey considers the authority of state regulators to enforce the provisions of the MLA with regard to each type of consumer credit specifically defined by 32 C.F.R. §232.

1. State Enforcement for Payday Loans

Payday loans are primarily made by non-bank lenders, putting them outside the authority of federal banking regulators. The Consumer Financial Protection Bureau (CFPB) has authority to regulate non-depository lenders, including payday lenders of any size, under §1024 of the 2010 Dodd-Frank Act now that a director has been appointed to head the bureau.²¹⁸ The CFPB is empowered to enforce a long list of federal credit laws as well as to define and enforce unfair, deceptive and abusive practices. As CFPB supervises payday lenders, the agency is obligated to

²¹⁸ See Letter dated Jan. 10, 2011, to Rep. Spencer Bachus and Rep. Judy Biggert from Eric M. Thorson and Elizabeth A. Coleman, forwarding "Joint Response by the Inspectors General of the Department of the Treasury and Board of Governors of the Federal Reserve System: Request for Information Regarding the Bureau of Consumer Financial Protection," at 4-6, available at <http://www.treasury.gov/about/organizational-structure/ig/Documents/OIG-CA%2011004%20Committee%20of%20Financial%20Services%20Response%20CFPB.pdf>.

examine for compliance with federal consumer protection laws, but was not given specific enforcement authority in Dodd-Frank under the Military Lending Act. The CFPB Short-Term, Small-Dollar Lending Examination Procedures manual, issued January 19, 2012, requires examiners to check for violations of the DoD MLA application requirement:

*In assessing application risks to consumers, examiners may find evidence of violations of – or an absence of compliance policies and procedures with respect to – other laws applicable to payday lending, such as the Military Lending Act. In these circumstances, examiners should identify such matters for possible referral to federal or state regulators or other appropriate action.*²¹⁹

The authority of state regulators to enforce the MLA provisions regarding payday loans varies across two separate dimensions. The first dimension is the extent to which high cost payday lending is authorized under state law. The MLA does not preempt state laws that provide protection in addition to those it specifies, and a significant minority of states, plus the District of Columbia, have enacted effective prohibitions on payday lending.²²⁰ Georgia specifically bans payday lending by statute, and Virginia specifically bans all payday lending to members of the military.²²¹ Fifteen states plus the District of Columbia have passed small loan rate caps or criminal usury caps at or below the 36% APR limit established by the MLA that act as a defacto prohibition on payday lending.²²² In addition, Maine and Oregon have capped small loan interest rates, but they allow for additional fees that can increase APRs on small loans into the triple digits.²²³

The second dimension to consider is how much authority state regulators have to enforce the provisions of the MLA in the states that do authorize payday lending. Thirty-three states authorize high cost payday lending. Of those, four states have included specific language in their payday loan statutes that authorizes state regulators to enforce the MLA and its implementing

²¹⁹ Consumer Financial Protection Bureau Short-Term, Small-Dollar Lending Examination Procedures, issued January 19, 2012. Available at www.ConsumerFinance.gov

²²⁰ Payday loans are traditionally defined as small-dollar, loans of temporary duration (typically 1-2 weeks) that are secured by the borrower's personal check held for future deposit or electronic access to the borrower's account. The interest rates charged for such loans are typically very high, with APR's frequently reaching triple digits. A number of states effectively prohibit payday lending by instituting small loan rate caps or criminal usury caps set at or below the 36% APR limit established by the MLA. Others have passed statutes that specifically ban payday lending. The states who have explicitly or effectively banned payday lending are: GA, NY, NJ, AR, AZ, CT, MD, MA, NC, PA, VT, WV, NH, MT, OH, and DC. In addition, Virginia has explicitly banned payday lending to members of the military. "Payday Loan Consumer Information," Consumer Federation of America, accessed December 5, 2011. <http://www.paydayloaninfo.org/facts>.

²²¹ See GA. CODE §16-17-1 *et seq* (2011); VA. CODE §6.2-1816 (21) (2011)

²²² See *e.g.* ARK. CONST. art. 19 §13 (2011); ARIZ. REV. STAT. §6-632 (A) (2011); N.J. STAT. §2A:21-19(a)(2) (2011); MD. COM. LAW §12-306 (2011); MASS. GEN. LAWS ch. 140 §96(a) (2011) *and* 209 MASS. CODE REGS. §26.01 (2011); W. VA. CODE §46A-4-107(2) (2011). Among the states that have implemented low rate caps, Ohio remains an exception where payday lending is still pervasive. Despite a 28% rate cap, lenders have continued to offer what are in substance, high-cost payday loans by re-structuring their products as installment loans. See POLICY MATTERS OHIO, NEW LAW, SAME OLD LOANS: PAYDAY LENDERS SIDESTEP OHIO LAW (2009) at 1-2.

²²³ See ME. REV. STAT. tit. 9-A, §2-201(2)(A)(2011) (Capping interest rates at 30%, but permitting additional tiered fees); OR. REV. STAT. §725.340 (2011) (Capping interest rates at 36%, but permitting additional fees and expenses).

regulations.²²⁴ Twenty-one states have more general language in their payday lending statutes that make violation of “any law” or any “federal law” grounds for the revocation of a lending license.²²⁵ Such language tends to support enforcement of the MLA by state regulators, but there are some important caveats to note. First, these state statutes vary considerably in the degree of procedural protection that they afford to payday lenders. Numerous statutes give state regulators the authority to suspend a lender’s license on suspicion of violating any law, but most provide for notice and a hearing before the license can be permanently revoked.²²⁶ Colorado and Mississippi require that a final judgment have been entered against the licensee for any alleged violation.²²⁷ Utah limits the enforcement authority of state regulators to rulemaking in order to “promote or assure uniform application of or to resolve ambiguities in applicable state or federal laws or federal regulations.”²²⁸

The second important caveat to consider is that several of these statutes are worded in ways that may be subject to varying interpretations. For example, Washington state’s statute requires a crime of dishonesty or financial misconduct before state regulators may act.²²⁹ Oklahoma and Kansas have similarly worded statutes, although Kansas also makes provision for license revocation if a lender has first been the subject of disciplinary action by another state or federal agency.²³⁰ The question of whether a lender could be subject to discipline by regulators in these states for violating the payday lending provisions of the MLA is one that would depend heavily on the particular facts of the case presented. Seven states lack either specific or general statutory language that would allow state regulators to directly enforce the MLA provisions regarding payday loans.²³¹ The statutes in these states do not refer to a violation of law other than state law

²²⁴ See CAL. FIN. CODE §23038(a) (2011); NEV. REV. STAT. §604A.442 (2011); 815 ILL. COMP. STAT. 122/2-51 (2011). Texas included language requiring payday and auto title lenders to comply with the MLA as part of a recently passed bill regulating payday lenders. The bill was signed into law by the governor on June 17, 2011, and goes into effect on January 1, 2012. See TEX. H.B. 2594 (2011) *to be codified at* TEX. FIN. CODE §393.201.

²²⁵ Those 21 states are: AK, AL, CO, DE, FL, IA, ID, IN, KY, KS, MI, MO, MS, ND, NH, OK, RI, SC, SD, TN, UT, and WA. It is important to note that Ohio would also fall into this category, since payday lending still occurs there in practice. OHIO REV. CODE §1315.15(A)(2)(a) (2011). Examples of relevant statutory language include: “Any lender licensed pursuant to this section who fails refuses or neglects to comply with the provisions of this section, or any laws relating to consumer loans or commits any criminal act may have its license suspended or revoked by the director of finance...” MO. REV. STAT. §408.500 (9) (2011); “...The superintendent may, after notice and hearing pursuant to chapter 17A, take disciplinary action against a licensee if the superintendent finds any of the following: a. The licensee or any of its officers, directors, shareholders, partners, or members has violated this chapter, any rule adopted by the superintendent, or any other state or federal law applicable to the conduct of its business.”; “(A) The board may suspend or revoke a license issued pursuant to this chapter if, after notice and opportunity for hearing, the board issues written findings that the licensee has: 1) violated this chapter or applicable state or federal law.” S.C. CODE §24-39-210 (A)(1) (2011).

²²⁶ See e.g. MICH. COMP. LAWS §487.2166(1) (2011); N.H. REV. STAT. §399-A:7 (I)(i) (2011); IDAHO CODE ANN. §28-46-407(c) (2011); IND. CODE §42-4.5-3-504(1)(b) (2011).

²²⁷ See COLO. REV. STAT. §5-2-303(1)(k) (2011); MISS. CODE §75-67-527 (1)(d) (2011).

²²⁸ See UTAH CODE §7-23-501 (2)(B)(iii) (2011).

²²⁹ “(1) The director may issue and serve upon a licensee or applicant a statement of charges if, in the opinion of the director, any licensee or applicant:...(g) Commits a crime against the laws of the state of Washington or any other state or government involving moral turpitude, financial misconduct, or dishonest dealings.” WASH. REV. CODE §31.45.110 (1)(g) (2011).

²³⁰ See OKLA. STAT. tit. 59 §3115 (E)(6) (2011); KAN. STAT. §16a-2-3-303(e) and (g) (2011).

²³¹ Those seven states are: HI, LA, MN, NE, NM, WI, and WY. It is important to note that ME and OR would also fall into this category, since they technically still allow for payday loans made at interest rates in excess of the 36% rate cap established by the MLA. ME. REV. STAT. tit. 9-A, §2-303 (2011); OR. REV. STAT. §725.230 (2011).

as grounds for revocation of a lending license.²³² It is possible that state regulators might find grounds for enforcement based on some of the general language contained in these statutes, but that would also depend on the specifics of a given factual situation.²³³ In one of those states, Hawaii, legislation is being considered to authorize the Department of Commerce and Consumer Affairs to enforce the federal Military Lending Act.²³⁴

An additional consideration is whether the loan product defined by state law authorizes loans not covered by the DoD definition of a payday loan. For example, Colorado's payday loan law currently requires a minimum six-month loan term, well outside the 91-day term limit for covered payday loans. The new Texas law authorizing payday and car title loans arranged by credit services businesses requires compliance with the Military Lending Act but does not require loans to fit the definitions of covered payday or car title loans. It is likely that a lender could make payday loans to servicemembers in those states without being in violation of the Military Lending Act.

2. State Enforcement for Car Title Loans

Like payday loans, car title loans are typically made by non-depository lenders, meaning that they fall under the primary authority of state regulators and the CFPB.²³⁵ The authority of state regulators over car title loans must also be considered across two dimensions. The first is the extent to which car title loans are authorized and supervised under state law. A majority of states plus the District of Columbia do not authorize title lending.²³⁶ Maine explicitly prohibits auto title lending by statute, and Virginia explicitly prohibits auto title lending to members of the

²³² Examples of relevant statutory provisions include: “The administrator may issue to a person licensed under this act an order to show cause why his license should not be revoked or suspended...if he finds that: (i)the licensee has repeatedly and willfully violated this act or any rule or order lawfully made pursuant to this act.” WYO. STAT. §40-14-635 (2011); “ The commissioner may apply the provisions of Parts I, VII, VIII, IX, and X of Chapter 2 of this Code Title, the Louisiana Consumer Credit Law, for purposes of administering and regulating the activities of licensees and the provisions of this Chapter.” LA. REV. STAT. §9:3578.8 (2011).

²³³ For example, several of these statutes contain language similar to the following: “The director may, following a hearing in accordance with the Administrative Procedure Act, suspend or revoke any license issued pursuant to the Delayed Deposit Services Licensing Act if he or she finds:... (b) A fact or condition existing which, if it had existed at the time of the original application for such license, would have warranted the director to refuse to issue such license.” NEB. REV. STAT. §45-922 (2011). It is possible that a state regulator might use such a provision as a basis for action against a lender found to be in violation of federal law.

²³⁴ House Bill 2409 was approved by the House Committee on Finance in late February, according to news reports February 23, 2012.

²³⁵ See Note 8, *supra*.

²³⁶ Auto title loans are short-term, high-cost loans, secured by title to a customer's vehicle. The amount loaned typically represents 30 to 50% of the vehicle's value, and the interest rate charged is typically in the triple digits. A number of states effectively prohibit car title lending by declining to explicitly authorize the practice, effectively subjecting car title lenders to small loan or criminal usury rate caps. Others have passed statutes that explicitly prohibit car title lending or subject car title loans to explicit rate caps set at or below the 36% APR limit established by the MLA. Jurisdictions that have not explicitly authorized car title lending, have affirmatively prohibited the practice, or have implemented rate caps are: AK, AR, CO, CT, FL, HI, IN, IA, KY, LA, MA, ME, MI, MD, MT, NE, NC, ND, NJ, NY, OH, OK, PA, RI, VT, WA, WV, WY, and DC. Car title loans are made in CA under the small loan law, with loans larger than \$2,500 to avoid rate caps. In addition, Virginia has explicitly banned auto title lending to members of the military. See Leah A. Plunkett and Ana Lucia Hurtado, *Small Dollar Loans, Big Problems: How States Protect Consumers from Abuses and How the Federal Government Can Help*, 44 SUFFOLK U. L. REV. 31, 64-88 (2010).

military.²³⁷ While Louisiana prohibits car title lending under its pawn law, some loans secured by vehicle titles are made under the Louisiana Consumer Credit Law and loans for \$350 or more with a duration exceeding two months avoid state restrictions on payday lending.²³⁸ In the states plus the District of Columbia that do not explicitly authorize auto title lending, the product is effectively prohibited by one or more generally applicable state laws.²³⁹ Florida, Kentucky, Iowa, Vermont, and Montana have set explicit rate caps on auto title loans at or below the 36% limit mandated by the MLA.²⁴⁰ Minnesota, Oregon, and Tennessee also set explicit rate caps on auto title loans, but their statutes allow for additional fees that may push the total cost of a small loan beyond 36% APR.²⁴¹ In early 2012, New Hampshire's legislature restored car title lending at 300 percent APR rates without prohibiting loans to servicemembers.

The second dimension to consider is the extent of state regulators' enforcement authority in those jurisdictions that do authorize auto title lending. Seventeen states have authorized auto title lending at rates that exceed the MLA 36% rate cap. In early 2012, New Hampshire's legislature restored car title lending at 300 percent APR without prohibiting loans to servicemembers.²⁴² Three states that authorize high cost title lending have adopted specific statutory language requiring lenders to comply with the terms of the MLA.²⁴³ However, Texas legislation effective in 2012 authorizes car title loans made via credit services businesses with no rate cap and no requirement that loan terms meet the DoD definitions of a covered car title loan, making the Texas law's requirement that lenders comply with the MLA an empty promise. Missouri and South Dakota have adopted general language making the violation of "any law" a valid basis for

²³⁷ See LA. REV. STAT. §37:1801(D) (2011) (prohibiting motor vehicle "title only" pawn transactions); ME. REV. STAT. tit. 30-A, §183-3960 (2011) (excluding motor vehicle titles from the definition of "tangible personal property" acceptable in pawn transactions); VA. CODE §6.2-2215 (15) (2011).

²³⁸ La. Rev. Stat. Ann. Section 9: 3519, 3530.

²³⁹ For example: In New York, title loans remain subject to the state's 25% criminal usury cap. See N.Y. PENAL LAW §190.40 (2011). In Arkansas, title loans remain subject to the 17% usury cap established in the state's constitution. ARK. CONST. art. 19 §13 (2011); Connecticut has a default rate cap of 12% APR unless an exception is explicitly authorized under state law. CONN. GEN. STAT. §37-4 (2011); Ohio has a criminal usury cap of 25% unless an exception is explicitly authorized by state law. OHIO REV. CODE §2905.21 (2011); and Pennsylvania has a criminal usury cap of 36% unless an exception is explicitly authorized by state law. 18 PA. STAT. §4806.1(h) (2011).

²⁴⁰ FLA. STAT. §537.001-537.018 (Capping interest at tiered rates between 18% and 30% based on loan amount); MON. CODE §31-1-817 (2011) *as amended by* Montana Loan Interest Rate Limit, Initiative No. 164 (I-164) (2010) (effective Jan. 1 2011) (Capping interest rates at 36%); KY. REV. STAT. §§286.10-260, 286.4-530 (2011) (Capping interest at tiered rates between 24% and 36%); IOWA CODE §§536A.23, 537.2403 (2011) (Capping interest rates at 10% plus limited allowable fees); VT. STAT. tit. 9 §41a(b)(4) (2011) (Capping interest rates between 18% and 20% based on model year of car used to secure loan).

²⁴¹ See N.H. REV. STAT. §399-A:14 (2011); MINN. STAT. §325J.07 (2011); OR. REV. STAT. §725.615 (2011); TENN. CODE § 45-15-111 (2011).

²⁴² See Associated Press, *NH House Passes Vetoed Title Loan Bill*, BOSTON GLOBE, Jan. 4, 2012, available at http://www.boston.com/news/local/new_hampshire/articles/2012/01/04nh_house-passes_title_loan_bill/. The measure takes effect on March 4, 2012.

²⁴³ See NEV. REV. STAT. §604A.442 (2011); TEX. H.B. 2594 (2011) *to be codified at* TEX. FIN. CODE §393.201. The Illinois payday lending statute also includes explicit language requiring compliance with the MLA. However, auto title lenders are not necessarily required to apply for a license under the payday lending statute. Therefore it is possible that an auto title lender who is not also licensed as a payday lender would not be subject to that provision. Compare 815 ILL. COMP. STAT. 122/2-51 (2011) (payday lending) with 205 ILL. COMP. STAT. 670/9 (2011) (general licensing provisions governing auto title lenders).

the suspension of an auto title lending license.²⁴⁴ As with payday lending, there are states that place procedural limitations on enforcement authority that go beyond the typical notice and hearing requirement. Mississippi requires a final judgment against a lender before a license can be revoked.²⁴⁵ Utah permits state regulators to engage in rulemaking, but does not explicitly authorize enforcement actions based on violations of law other than state law.²⁴⁶

Arizona, Kansas, and Alabama each have enacted general statutory language that could allow for enforcement in some, but not all cases where auto title lenders violate the MLA. Alabama requires a licensee to have been “convicted of a crime that the supervisor finds directly relates to the duties and responsibilities of the occupation of pawnbroker,” language indicating that enforcement authority would exist only in cases of criminal conviction.²⁴⁷ Arizona permits revocation in case of “[c]onviction in any state of a felony or a misdemeanor involving breach of trust or dishonesty,” language indicating that only certain convictions would be a valid basis for enforcement action.²⁴⁸ Kansas allows state regulators to suspend a lender’s license if, “the applicant, licensee, members thereof if a co-partnership or association, or officers and directors thereof if a corporation have been convicted of a felony crime or any crime involving fraud, dishonesty or deceit” or “the applicant or licensee has been the subject of any disciplinary action by this or any other state or federal agency.”²⁴⁹ Six states lack specific or general statutory language that would allow state regulators to directly enforce the MLA provisions on auto title lending.²⁵⁰ Georgia and Minnesota allow for independent licensing of pawnbrokers by municipal authorities, meaning that possible grounds for enforcement actions could vary significantly within the state.²⁵¹ The remaining five state auto title statutes contain little or no language that would potentially grant state regulators authority to enforce the MLA.²⁵²

3. State Enforcement for Refund Anticipation Loans

Refund Anticipation Loans (RALs) are also defined as covered consumer credit by the DOD implementing regulation. However, unlike payday loans and car title loans, most RALs are

²⁴⁴ See MO. REV. STAT. §367.532 (1) (2011) (“Any title lender which fails, refuses or neglects to comply with sections 367.500 to 367.533, sections 408.551 to 408.557, sections 408.560 to 408.562, or any laws relating to title loans or commits any criminal act may have its license suspended or revoked by order of the director...”); S.D. CODIFIED LAWS §54-4-49 (1) (2011) (“If the licensee is the holder of more than one license, the director may suspend or revoke any or all of the licenses. For purposes of this section, good cause includes any of the following:(1) Violation of any statute, rule, order, or written condition of the commission or any federal statute, rule, or regulation pertaining to consumer credit...”); New Hampshire has similar enforcement language currently in effect, N.H. REV. STAT. §399-A:7 (I)(i) (2011). It is also important to note that Tennessee’s auto title lending statute contains similar language since allowable fees in Tennessee permit title lenders to charge in excess of 36% APR. TENN. CODE §45-15-107(a)(7) (2011).

²⁴⁵ MISS. CODE §75-67-423 (1)(d) (2011).

²⁴⁶ UTAH CODE §7-24-301 (2)(B)(iii) (2011).

²⁴⁷ ALA. CODE §5-19A-13 (a)(4) (2011).

²⁴⁸ ARIZ. REV. STAT. §44-283 (A)(5) (2011).

²⁴⁹ KAN. STAT. §16a-2-3-303 (e) (g) (2011).

²⁵⁰ These six states are: GA, DE, ID, WI, SC, and NM. It is important to note that MN would also fall into this category, since lenders in that state are authorized to charge in excess of 36% for an auto title loan. See MINN. STAT. §325J-02 (2011).

²⁵¹ See GA. CODE §44-12-136 (2011); MINN. STAT. §325J-02 (2011).

²⁵² See IDAHO CODE §28-46-508 (2011); N.M. STAT. §58-15-8 (2011); DEL. CODE tit. 5, §§2250-2261(2011); S.C. Code §37-3-504 (2011); WIS. STAT. §138.14(9) (2011).

financed by depository institutions, meaning that they are primarily monitored by federal banking regulators. Those regulators have recently adopted the position that RALs are no longer viable for banks after the IRS eliminated the Debt Indicator, a service that facilitated RAL lending by disclosing whether a tax refund would be intercepted to pay pre-existing debts.²⁵³ In 2010, the major banks that financed most RALs began to exit the market. JP Morgan Chase left the market voluntarily, the Office of the Comptroller of the Currency issued a directive against HSBC prohibiting it from making RALs, and the FDIC notified the banks that it regulates that it considered RALs to be “unsafe and unsound.”²⁵⁴ As of 2011, there were only three small state banks still making RALs and they have each been ordered to exit the market by the FDIC.²⁵⁵ In December 2011 the FDIC reached a settlement with Republic Bank & Trust that will terminate RAL lending by the last bank in the business following the end of the 2012 tax season. No banks will be financing RALs by the 2013 tax season.²⁵⁶

The state regulatory landscape for RALs is different from that of payday or auto title loans. Because RAL lenders are monitored by federal regulators, states are not heavily involved in regulating the tax preparers that market these loans. No state prohibits RALs, and only one state has attempted to cap the interest rates charged by RAL lenders, although the cap was successfully challenged on preemption grounds.²⁵⁷ Seventeen states impose additional disclosure requirements or fee limitations on RAL originators, but states typically exempt RAL lenders from the statutory provisions that form the basis for state enforcement authority over payday and auto title lenders.²⁵⁸ A few states require RAL originators to register with state regulators, but these statutes exempt national banks and contain only generalized obligations to refrain from fraudulent conduct.²⁵⁹ Most jurisdictions have chosen not to regulate RAL facilitators under state law.

²⁵³ Chi Chi Wu and Jean Ann Fox, END OF THE RAPID RIP-OFF: AN EPILOGUE FOR QUICKIE TAX LOANS, THE NCLC/CFA 2011 REFUND ANTICIPATION LOAN REPORT at 2 (2011).

²⁵⁴ *Id.*

²⁵⁵ *Id.* at 6.

²⁵⁶ Republic Bank & Trust was the lone remaining holdout against the FDIC’s order, but they reached a settlement on December 8, 2011 that calls for them to exit the RAL market after the 2012 tax season. Press Release, National Consumer Law Center, Consumer Advocates Praise FDIC Settlement to End RALs from Republic Bank & Trust (Dec. 9, 2011) available at <http://www.nclc.org/images/pdf/pr-reports/pr-republic-bank.pdf>.

²⁵⁷ Connecticut enacted a provision that capped RAL interest rates at 60% APR, but the Second Circuit ruled that the provision did not apply to national banks or to tax-return services representing national banks. *Pacific Capital Bank v. Connecticut*, 2008 U.S. App. LEXIS 19491 (2d Cir., 2008).

²⁵⁸ RALs are typically originated by tax preparation businesses, but until recently have been financed by banks with national charters, prompting states to regulate RAL lenders lightly to avoid preemption challenges. See notes 43 and 43, *supra*. See also e.g. NEV. REV. STAT. §604A.250 (2011) (Exempting RAL lenders from provisions of payday and auto title loan statute).

²⁵⁹ States that require RAL originators to register with state authorities are: NC, NY, TX, and WA. For examples of relevant statutory language, see e.g. WASH. REV. CODE §19.265.50 (2011) (RAL lenders may not, “...Engage in any dishonest, fraudulent, unfair, unconscionable, or unethical practice or conduct in connection with a refund anticipation loan.”); N.C. GEN. STAT. §53-245 (2011) (prohibiting RAL lenders from, “...Engaging in any transaction, practice, or course of business that operates a fraud upon any person in connection with a refund anticipation loan.”).

4. Alternative Enforcement Mechanisms

Outside of federal and state regulators, there are two other mechanisms for enforcing the provisions of the MLA. However, each has practical limitations that would limit its widespread effectiveness.

Armed Forces Disciplinary Control Boards: DOD policy allows for local Armed Services Disciplinary Control Boards (ASDCBs) to recommend to installation commanders that local businesses be placed off limits to servicemembers if the board finds that businesses have engaged in unfair commercial or consumer practices.²⁶⁰ Establishments are placed off-limits when they are judged to be a hazard to “good order and discipline,” typically with a history of police incidents such as fights, drug busts, and other illicit activities. There is limited systematic evidence available regarding the effectiveness of ASDCBs as an enforcement mechanism for a consumer protection requirement, but anecdotal evidence suggests that referral or threatened referral of a lender to the local board can be effective in persuading lenders to change their practices.²⁶¹ Unfortunately, effective enforcement through local ASDCBs requires a number of practical conditions to be satisfied that cannot be taken for granted. A board must be made aware of potentially illegal activity on the part of lenders, the board must meet and decide to act, the base commanding officer must issue orders based on the board’s recommendation, and individual servicemembers must be made aware of those orders. That process is lengthy and can easily break down due to miscommunication or disruptions due to frequent deployments.²⁶² Even putting aside questions of potential delays and ineffectiveness, ASDCB’s are only capable of addressing problems one company at a time at a local level, place the onus on servicemembers for frequently an off-limits lender, and would not be an ideal enforcement mechanism for widespread patterns of violation.

Private Right of Action: A final potential enforcement alternative is the private right of action. Although the MLA does not explicitly authorize private enforcement actions, the MLA and implementing regulations contain a provision stating that the rights of servicemembers to seek consequential and punitive damages under state or federal law for violations of the MLA are preserved.²⁶³ The availability of damages to individual servicemembers will vary greatly based on the individual facts of their case but, even assuming that an individual has a valid claim, they still face the economic obstacles associated with finding a private attorney willing to represent them. The MLA does not provide for specific civil penalties for violations.

The former Governor of Georgia late in 2011 filed a private suit on behalf of an Army staff sergeant, alleging violations of the MLA, and seeking class action certification on behalf of other

²⁶⁰ GOVERNMENT ACCOUNTABILITY OFFICE, *MILITARY PERSONNEL: DOD’S TOOLS FOR CURBING THE USE AND EFFECTS OF PREDATORY LENDING NOT FULLY UTILIZED* (2005) at 12-13.

²⁶¹ *Id.* at 14.

²⁶² *Id.* at 13 (suggesting also that boards may be hesitant to act against local lenders, given the high investment of time required, as long as lenders are acting within the confines of state or local law).

²⁶³ 32 C.F.R. §232.9(b) (2006) (“The remedies and rights provided under 10 U.S.C. 987 as implemented by this part are in addition to and do not preclude any remedy otherwise available under State or Federal law or regulation to the person claiming relief under the statute, including any award for consequential damages and punitive damages.”).

similarly situated plaintiffs.²⁶⁴ The outcome of this certification dispute will likely influence the future economics of private MLA enforcement suits and the willingness of private attorneys to represent individual servicemembers. If class action certification proves difficult or impossible to obtain, it is likely that the substantial costs and the high degree of uncertainty associated with litigation will prevent most individual servicemembers from seeking private enforcement.

²⁶⁴ Russ Bynum, *Army Staff Sgt. Jason Cox Claims He Was Predatory Lending Victim*, The Huffington Post, November 22, 2011, available at http://www.huffingtonpost.com/2011/11/22/jason-cox-soldier-predatory-lending-victim_n_1108504.html.

XII. No Impact of Military Lending Act Allotment Protections

The Military Lending Act prohibits the use of allotments as security for loans to covered servicemembers. However, this protection only applies to products defined as “consumer credit,” namely payday, car title, and tax refund loans. These types of credit are not typically structured to be paid by allotment. Payday loans by definition are loans based on holding the borrower’s personal check or, in some states, debit authorization to collect payment directly from the borrower’s account at a financial institution. CFA has never seen a car title lender use allotments to collect payments. Tax refund loans are repaid via the bank that extends the loan withholding loan payment and tax preparation fees from the direct deposit of the borrower’s tax refund from the Internal Revenue Service.

The types of credit frequently paid via allotments (payroll deductions paid by the Department of Defense directly from wages) include military installment loans and sales finance credit at car lots and retailers or rent to own stores around military bases. The MLA protection against mandatory payment via allotments has had no impact since the DoD rules excluded the types of loans typically paid by allotment. In some cases payment by allotment is required while more typically allotments are the preferred or default method of payment.

The current system of paying for commercial credit via allotments works against the Pentagon’s Quality of Life areas of the DoD Social Compact. The Department of Defense Financial Readiness Campaign lists “8 Pillars of Financial Readiness,” including “Maintain Good Credit,” “Achieve Financial Stability,” and “Utilize low-cost loan products as an alternative to payday lending and predatory loans.”²⁶⁵ Allotments are used to enable servicemembers to buy on credit without regard to ability to repay or to the cost, terms, or extent of indebtedness that results.

A. How Allotments Work

The Department of Defense permits servicemembers to make allotments of their pay in order to facilitate the payment of third parties for obligations, debts, purchases, savings, and investment.²⁶⁶ Allotments direct portions of military pay to specified purposes prior to deposit of pay into the servicemember’s account and are classified as either discretionary or non-discretionary according to the purpose of the allotment and whether the payment being made is voluntary.²⁶⁷

²⁶⁵ David Julian, Office of Personal Finance, Information Paper, Subject Department of Defense (DoD) Financial Readiness Campaign, on file with CFA.

²⁶⁶ “Allotments are a definite portion of a member’s pay and allowances, and are authorized to be made payable to a qualified person or institution. Some Allotments can have an indefinite time-frame, while others can have a specified time-frame...” “PAY ALLOTMENTS,” DEFENSE FINANCE AND ACCOUNTING SERVICES, accessed October 24, 2011. <http://www.dfas.mil/militarymembers/paydeductions/allotments.html>.

²⁶⁷ Discretionary Allotments are completely voluntary, and can include: payments of life insurance premiums, payments to dependents, deposits and investments, mortgage or rent payments, or payments of consumer loans. Non-discretionary allotments can be either involuntary or voluntary, and can include: charitable contributions, payments of child and spousal support, payment of government debt, and payment of commercial debt if the service member fails to voluntarily repay the debt and the creditor makes an application to recover money owed. *Id.*

Allotments are authorized by statute and governed by both the Department of Defense Financial Management Regulation and regulations issued by the individual military service branches.²⁶⁸ The process for creating an allotment varies with the type of allotment, but voluntary allotments are created when a servicemember submits a completed copy of DD Form 2558.²⁶⁹ The form then serves as authorization for the Defense Finance and Accounting Service (DFAS) to begin making deductions from the servicemember's Master Military Pay Account (MMPA) and making corresponding payments to the specified allotment payee.²⁷⁰ DFAS will continue to make deductions and payments until the allotment is terminated either by the servicemember or by the occurrence of certain specified events.²⁷¹

This section examines issues raised by the use of allotments to pay for loans, credit purchases, and rent-to-own transactions, and the extent to which the MLA protections apply to the commercial credit sector to benefit servicemembers.

B. Discretionary Allotments for Payment of Commercial Debt

Servicemembers may make voluntary allotments of their pay for a number of purposes, but a voluntary allotment made for the purpose of paying a commercial debt is classified as a discretionary allotment.²⁷² A servicemember cannot have more than six discretionary allotments active per pay period, and no more than one can be active for the same allotment payee.²⁷³ This one-allotment per payee limit is undermined by the bank that processes most allotments for creditors. There is no restriction on the amount of a servicemember's salary that may be subject to voluntary allotment, theoretically permitting servicemembers to assign all their income to the payment of commercial debts before they even receive the pay deposit into accounts.²⁷⁴

The long-standing Federal Trade Commission rule on credit practices does not protect servicemembers who pay by allotment. While lenders are prohibited from requiring irrevocable wage assignments in a lending contract by the FTC's Credit Practice Rule (CPR), payroll deduction plans, such as the military allotment system, are not covered by the ban on wage assignments.²⁷⁵ Therefore, voluntary allotments offer an attractive mechanism for commercial creditors to gain access to a servicemember's salary in order to guarantee repayment of a loan.

²⁶⁸ See 37 U.S.C.A. §701 (2011); Department of Defense Financial Management Regulation (DODFMR), Vol. 7A, chs. 40-43 (2011). See also e.g. Army Regulation (AR) 37-104-4, ch. 24 (2005).

²⁶⁹ AR 37-104-4, ch. 24 (2005).

²⁷⁰ *Id.*

²⁷¹ The process for terminating an allotment also varies according to the type of allotment. Voluntary allotments can be terminated by a service member who submits another copy of DD Form 2558, requesting termination. Certain allotments are also intended to last for a specified number of pay periods, and will then terminate automatically. Allotments are also automatically terminated by the death of the service member, the beginning of a court martial, or a reduction in pay that leaves insufficient funds to make the allotted payment. DODFMR, Vol. 7A, ch. 40, §4008 (2011).

²⁷² See note 2, *supra*. See also DODFMR, Vol. 7A, ch. 40, Section 4003.

²⁷³ DODFMR, Vol. 7A, chs. 40-43 (2011).

²⁷⁴ Consumer Federation of America, Comments to the Consumer Financial Protection Bureau Regarding Consumer Financial Products Offered to Service Members, 76 Fed. Reg. 54998 (Sept. 6, 2011), p. 5.

²⁷⁵ 16 C.F.R. §444.2(a)(3) (2007).

C. Involuntary Allotments to Collect Commercial Debt

Federal law and military regulations place more limits on the **involuntary** collection of debts from servicemembers' military pay. The law distinguishes between commercial debt and other obligations such as spousal and child support or state and federal taxes.²⁷⁶ Creditors seeking to involuntarily collect a commercial debt from active-duty military members must apply for an involuntary allotment in accordance with regulations issued by the Secretary of Defense.²⁷⁷ The creditor must first serve a certified copy of a final judgment issued by a civil court in compliance with the Servicemembers' Civil Relief Act along with a completed copy of DD Form 2653 on DFAS.²⁷⁸ After 90 to 120 days, if the application for involuntary allotment is approved, creditors may take a maximum of 25% of a servicemember's disposable income.²⁷⁹ The 25 % limit applies to all involuntary allotments, and payments to satisfy garnishments for spousal or child support take priority, followed by all other involuntary allotments on a first-come, first-serve basis.²⁸⁰ As a result, any creditor seeking to collect against a servicemember with pre-existing involuntary allotments may be forced to wait, potentially for years, until prior debts have been satisfied.²⁸¹

D. Use of Voluntary Allotments by High Cost Sellers and Lenders

Voluntary allotments are a very attractive financing option for lenders/sellers as a way to assure loan repayment. Since voluntary allotments are deducted before pay is distributed to servicemembers, and as there are no limits on the percentage of pay that can be allotted, lenders are guaranteed priority of payment as long as the allotment remains in effect.²⁸² As the Client Manual for one allotment processor notes, the allotment processing system "places the lender at the top of the Military Member's bill paying list."²⁸³ This gives creditors a powerful incentive to accomplish two goals when lending to servicemembers: 1) obtain initial authorization for a voluntary allotment; and 2) ensure that the authorization remains effective for as long as possible. The first goal is best accomplished by requiring or strongly encouraging payment by

²⁷⁶ See COLLECTING COMMERCIAL DEBT FROM A MILITARY MEMBER," DEFENSE FINANCE AND ACCOUNTING SERVICES, accessed October 24, 2011. <http://www.dfas.mil/garnishment/milcommdebt/debtcollect.html>.

²⁷⁷ 32 C.F.R. §§112,113 (1995).

²⁷⁸ See COLLECTING COMMERCIAL DEBT FROM A MILITARY MEMBER," DEFENSE FINANCE AND ACCOUNTING SERVICES, accessed October 24, 2011. <http://www.dfas.mil/garnishment/milcommdebt/debtcollect.html>. See also 32 C.F.R. §§112,113 (1995). The Servicemembers' Civil Relief Act grants service members a number of legal protections, but in the context of debt collection it specifically protects unrepresented service members against the entry of default judgments. See Pub. L. No. 108-189, 117 Stat. 2835 (2003) (codified at 50 U.S.C. app. §§ 501-596 (2011)).

²⁷⁹ "The maximum amount that may be withheld from individual's pay for garnishments or other legal process to satisfy commercial debts is 25 percent of the individual's disposable pay. Disposable pay is the gross pay minus certain authorized deductions, such as income tax withholding or debts owed to the government." COLLECTING COMMERCIAL DEBT FROM A MILITARY MEMBER," DEFENSE FINANCE AND ACCOUNTING SERVICES, accessed October 25, 2011. <http://www.dfas.mil/garnishment/milcommdebt/debtcollect.html>. See also 32 C.F.R. §§112; 113 (1995); DODFMR, Vol. 7A, ch. 41 §41408 (2011).

²⁸⁰ DODFMR, Vol. 7A, ch. 41 §41408 (2011).

²⁸¹ COLLECTING COMMERCIAL DEBT FROM A MILITARY MEMBER," DEFENSE FINANCE AND ACCOUNTING SERVICES, accessed October 24, 2011. <http://www.dfas.mil/garnishment/milcommdebt/debtcollect.html>.

²⁸² See DEPT. OF DEFENSE, REPORT ON PREDATORY LENDING PRACTICES DIRECTED AT MEMBERS OF THE ARMED FORCES AND THEIR DEPENDENTS (2006). ("The lender only considers the borrowers' income and presumes that their loans will be paid prior to other requirements. The use of checks, access to bank accounts, mandatory allotments and car titles pressure the borrower to consider loan payments as being their top priority.").

²⁸³ MAC Ease Allotment Client Manual, p. 21, obtained from company website December 19, 2011.

allotment as an initial condition of the loan. The second goal is accomplished by verifying the remaining term of the enlistment when credit is extended and setting up loan repayment terms to last for that period of time. For example, a CFA researcher visited a rent to own store near Fort Leonard Wood in Missouri and was told that civilians were limited to one year of payments while soldiers' rent-to-own transactions were automatically set for two years, via allotment.

There is no DFAS screening of the types of creditors that can be repaid via allotment. Allotments from each bi-monthly paycheck are deposited into savings accounts in the name of the servicemember held at the allotment processor's bank, with payments to individual creditors subsequently made monthly by the bank. DFAS only sees the bank information and servicemembers are limited to one allotment to the bank. Given the bundling system used by FirstNet and MAC, DFAS does not receive information on the identity of sellers or lenders ultimately paid via allotments.

E. Military Lending Act Prohibits Allotments as Security for Loans

In 2007, Congress passed the Military Lending Act (MLA), authorizing the DOD to issue regulations to establish new consumer lending safeguards for servicemembers.²⁸⁴ The Military Lending Act explicitly prohibited creditors from requiring repayment by voluntary allotment for "consumer credit," with the Department of Defense authorized to determine which credit products would be so designated.²⁸⁵ The DoD regulations narrowly define "consumer credit" as payday, car title, and tax refund anticipation loans, allowing lenders to demand repayment by "voluntary" allotment if their loans fall outside those definitions.²⁸⁶ And the types of credit that typically are repaid via allotments are not covered by the DoD definitions at all.

Military installment loans and unsecured credit installment financing do not fall within the DOD's definition of "consumer credit." These lenders typically steer their customers toward payment by allotment, which they claim to prefer out of convenience to the servicemember.²⁸⁷ Some rent-to-own outlets near military bases collect payment via allotments and are not covered by the MLA prohibition against mandatory allotment payments. Military installment lenders market their expertise in lending to the military to retailers so that servicemembers can finance purchases to be repaid via allotments. Even if payment by allotment is not required as a

²⁸⁴ John Warner Defense Authorization Act for Fiscal Year 2007, Pub. L. No. 109-364, 120 Stat. 2083 (2006) codified at 10 U.S.C. §987 (2011).

²⁸⁵ Limitations on Terms of Consumer Credit Extended to Service Members, 32 C.F.R. §232.8(a)(6) (2006).

²⁸⁶ Consumer Credit is defined as: "[C]losed-end credit offered or extended to a covered borrower primarily for personal, family or household purposes..." The definition explicitly includes: 1) Payday loans, which are defined as: "Closed-end credit with a term of 91 days or fewer in which the amount financed does not exceed \$2,000..."; 2) Vehicle Title Loans, which are defined as: "Closed-end credit with a term of 181 days or fewer that is secured by the title to a motor vehicle, that has been registered for use on public roads and owned by a covered borrower, other than a purchase money transaction..."; and 3) Tax Refund Anticipation Loans, which are defined as: "Closed-end credit in which the covered borrower expressly grants the creditor the right to receive all or part of the borrower's income tax refund or expressly agrees to repay the loan with the proceeds of the borrower's refund." 32 C.F.R. §232.3(b)(1) (2010). The regulation then exempts all credit that is not "consumer credit."

²⁸⁷ For example, military installment lender Omni Military Loans states on their website: "The recommended repayment method for active duty military is by military allotment. Omni Financial recommends allotment repayment because DFAS instituted discretionary allotments for the convenience of the service member." FREQUENTLY ASKED QUESTIONS," OMNI MILITARY LOANS, accessed October 31, 2011. Available on the web at <http://www.yesomni.com/faq> .

condition of getting credit, it is often presented as an attractive repayment option that eliminates the need for servicemembers to ensure that payments are made on time.²⁸⁸ Because the MLA ban on payment by mandatory allotment only applies to DoD-defined “covered credit,” servicemembers are deprived of this fundamental protection of their earned pay for all other types of discretionary commercial credit payments. In addition, payment by allotment is often presented as the default or preferred payment method, along with payment via wire transfer or from consumers’ bank accounts. While not “mandatory,” lenders that specialize in the military sector strongly encourage borrowers to set up allotments to pay longer term loans and retail sales financing.

F. Bank and Payment Processors Handle Allotments

It is common for lenders to employ a single allotment processing company to collect payments from DFAS and distribute them to individual allotment beneficiaries. This middleman arrangement allows lenders and companies that sell loans and goods to servicemembers on credit to effectively circumvent the DOD limitation of six active discretionary allotments at any one time.²⁸⁹ A single allotment is established in the name of the servicemember at the processing bank in the servicemember’s name, which can then be used to make payments to multiple creditors without DFAS knowing the number or identity of the creditors being paid.

CFA was able to identify two major allotment payment processors, both located in Kentucky. FirstNet is the allotment processing division of First Citizens Bank of Kentucky, a subsidiary of Farmer’s Capital Bank Corp. In 2007, First Citizens Bank merged with the military allotment operation of PNC Bank, NA.²⁹⁰ FirstNet structures their allotments as savings accounts opened in the servicemember’s name at First Citizen’s Bank.²⁹¹ FirstNet charges \$3 per payment to handle the allotment, a fee that the New York Attorney General cited for not being disclosed by a retailer selling over-priced electronic equipment at a kiosk in the mall near Fort Drum.²⁹²

Another allotment payment processor, Military Assistance Company (MAC) claims to make \$20 billion in annual payments via allotments and claims to be the nation’s largest private allotment processor.²⁹³ MAC is based in Elizabethtown, Kentucky and is owned by Fort Knox National Company. Fort Knox National Company, founded in 1985 and headquartered in Louisville, KY, states that it processes over 24 million payments and moves \$32 billion annually for more than 300 companies in the utility, mortgage and financial services industries.²⁹⁴ It claims to have direct interface to Defense Finance and Accounting Service (DFAS). The MAC Client Manual

²⁸⁸ Pioneer Services, a prominent military installment lender, indicates that payment by allotment is one of their most popular payment options because; “Military life takes all your concentration. If you’re getting ready to deploy, you’ll have even more to think about. That’s why an allotment is such a good idea. It means one less bill you have to deal with, and it protects your credit by making sure your payments are always on time. An allotment makes your payments secure, convenient and off your mind.”SET UP AN ALLOTMENT,” PIONEER SERVICES, accessed October 31, 2011. <https://www.pioneermilitaryloans.com/customerservice/repayment.cfm?appID=>.

²⁸⁹ See note 8, *supra*.

²⁹⁰ SEC Form 10-K, Farmers Capital Bank Corporation, Fiscal Year Ended 12/31/10, p. 14.

²⁹¹ ”ALLOTMENTS FREQUENTLY ASKED QUESTIONS,” FIRSTNET, accessed November 1, 2011.

²⁹² Id.

²⁹³ www.allotment.net/AboutMAC.aspx, visited December 19, 2011.

²⁹⁴ Press Release, “Fort Knox national Company to Provide Innovative Payment Solutions for Arvest Bank Operations,” October 20, 2011.

does not state the per-transaction fee paid by the servicemember for each monthly transaction paid from the savings account held at Citizens Union Bank of Shelbyville, KY.

The structure of payment processors can make stopping an allotment more procedurally difficult for servicemembers.²⁹⁵ Once established, an allotment will continue to be withdrawn until the servicemember makes a written request, for example, to both Firstnet and DFAS.²⁹⁶ Servicemembers are not allowed any choice when these allotment accounts are established, and frequently they are not aware that they even exist.²⁹⁷ The car dealer, retailer, landlord or loan company selects the allotment payment processor to handle payments. Without adequate knowledge about the roles of third party processors in the allotment process, it becomes much more difficult for servicemembers to stop voluntary allotments that are theoretically terminable at will.

G. Allotment Issues and Policy Recommendations

The allotment system is a vestige of the era before electronic payment systems became widely available that make it easy for consumers to arrange electronic payments from their accounts at financial institutions. However, that doesn't necessarily mean that payment by allotment has no place in the modern military. Since servicemembers may be deployed for extended periods to remote locations where access to electronic payment systems is less available, allotments may still serve as a useful tool for maintaining a regular payment schedule for necessities, such as rent. Allotments do not depend on a servicemember to balance a bank account or to budget for payments to cover the credit paid via allotment. Funds from the servicemember's pay goes directly to those creditors before the remaining pay is available to cover other family needs, such as groceries or childcare.

Since DFAS apparently does not screen out any lenders or retailers from access to payment via allotment, the allotment system presents a tempting target for unscrupulous lenders and sellers who target servicemembers. A number of reforms could be implemented to preserve the benefits of the current allotment system while limiting the potential for exploitation.

The protections that consumers are provided when paying by credit or debit cards do not extend to payment via a payroll deduction plan such as military allotments. The Fair Credit Billing and other Truth in Lending Act protections for payment by credit card as well as the Electronic Fund Transfer Act protections for payment by debit cards tied to consumers' bank accounts do not apply to payment by allotment. In addition, the Federal Trade Commission's Credit Practices rule exempts payroll deduction plans.

²⁹⁵ Military Assistance Company (MAC) claims to be the largest private allotment processor in the world, handling over \$20 billion in payments annually. "ABOUT MAC," MILITARY ASSISTANCE COMPANY, accessed November 1, 2011. <https://www.allotment.net/AboutMAC.aspx>.

²⁹⁶ "There are two steps to stopping an allotment. First, the authorization FirstNet uses authorizes Firstnet to pay the company the amount you agreed. You must fax a letter with your signature, authorizing FirstNet to discontinue payments to the company. Second, you must contact your payroll or disbursing office and have the allotment stopped or decreased. If you only stop the authorization at FirstNet, the allotment will continue to come out of your pay and be deposited to your allotment Savings account." *Id.*

²⁹⁷ Letter from Andrew M. Cuomo, Attorney General of New York, to The Honorable Dr. Robert M. Gates, Secretary of Defense (May 10, 2010), available at http://www.ag.ny.gov/media_center/2010/may/pdf/SmartbuyLetter.pdf.

Recommendation: Expand Coverage of the Military Lending Act

By limiting the application of the Military Lending Act to narrowly defined classes of consumer credit, the DOD created the potential for lenders to require that loans be repaid by allotment as long as they make loans that fall outside the definition. Traditionally allotments have not been used to pay for the forms of credit defined by DoD as covered per the MLA. Payday loans are repaid from the next deposit to the borrower's bank account. Refund anticipation loans are repaid out of the direct deposit of the tax refund from the IRS into an account held in the taxpayer's name at the RAL-lending bank. Car title loans are often single payment loans, not the typical structure to be paid by recurring allotment payments. As a result of the narrow definition of covered credit, the key protection of the Military Lending Act was not applied to the types of credit that are typically repaid with this form of wage assignment. Expanding the DOD definition of covered credit to include open-ended credit products and installment loans, rent to own, and sales financing would help stymie efforts by lenders to compel or strongly encourage servicemembers to authorize repayment by allotment. Such a reform would have the additional benefit of expanding the other key protections of the Military Lending Act.²⁹⁸ Alternatively, the Consumer Financial Protection Bureau could issue a regulation expanding the Credit Practices Rule to include payroll deduction plans and finding that mandatory payment via allotment is an unfair trade practice, including any practice that makes it difficult for servicemembers to control payments from their military pay.

Recommendation: Modify Regulations Governing Voluntary Allotments

As previously discussed, voluntary or "discretionary" allotments are attractive to lenders as a repayment option because they represent a potentially unlimited form of wage assignment. DOD regulations governing discretionary allotments could be modified so that a limitation is placed on the percentage of income payable to commercial creditors, similar to the 25% limit in effect for involuntary allotments.²⁹⁹ If voluntary allotments were less of a carte blanche wage assignment, lenders would have stronger incentives to determine borrowers' ability to repay before extending credit. A percentage cap would also have a deterrent effect on the risk of servicemembers living beyond their means by capping the amount of income they can commit to debt payments before pay is received to pay for living essentials, such as food, childcare, and utilities. Such a cap could be implemented with minimum difficulty based on the existing limitation for involuntary allotments.

Recommendation: Improve Disclosure Requirements for Third Party Allotment Processors

Third party allotment processors are frequently employed by creditors to act as intermediaries with DFAS. They represent an additional level of bureaucratic complexity that servicemembers

²⁹⁸ In addition to the prohibition on requiring payment by allotment, DOD's regulations issued under the MLA, *inter alia*, caps interest rates that can be charged to servicemembers at 36% APR, prohibits same-creditor rollovers, and requires written and oral disclosure of payment obligations. See 32 C.F.R. §232 (2010).

²⁹⁹ See note 15, *supra*.

must contend with if they want to modify or terminate existing voluntary allotments. These companies are chosen by the creditor, not by servicemembers who pay for their services, and the servicemembers may not be fully aware of their role in the processing of payments or the required procedures for changing or terminating existing allotments. Information regarding the identity of third-party processors, any fees that they charge, and any changes to procedure for termination should be added to the lender disclosures required under the MLA. In conjunction with an expanded definition of covered credit under the DOD regulations, such disclosures would help ensure that voluntary allotments are truly voluntary and terminable at the will of the servicemember.

XIII. Impact of MLA on Advocacy to Protect All Americans

The Military Lending Act campaign and aftermath created a high profile for the plight of active duty servicemembers as market participants, especially for financial service problems encountered by an all-volunteer fighting force during a recession. Recognition of military consumers as having unique problems in the marketplace has informed Congressional regulatory agencies in the years following 2006.

The informal coalition of veterans groups, military charities, and consumer advocates has convened from time to time to inform the public debate, including early formation of the Office of Servicemember Affairs at CFPB and work by the Federal Trade Commission to address auto financing abuses. Advocates for servicemembers were vocal in the debate over auto sales financing jurisdiction for CFPB and the Federal Trade Commission. One of the FTC field hearings on auto finance focused solely on military borrowers, a product where the Military Lending Act provides no protection. The CFPB's Office of Servicemember Affairs is headed by Holly Petraeus with the assignment to make sure protections and information are tailored to serve military families. CFPB's Office of Servicemember Affairs has testified before Congress on mortgage abuses in violation of the Servicemember Civil Relief Act and on student lending, and participated in a Senate Banking Committee hearing in late 2011 focused solely on the financial problems of military consumers.

Protections adopted by Congress to safeguard servicemembers became a talking point for the need for better protections for consumers as the Dodd Frank Act was debated and the Consumer Financial Protection Bureau was formed. Instead of replicating the MLA protections for all Americans, Congress gave the Consumer Financial Protection Bureau authority to supervise payday lenders, regardless of size, and for the first time established a federal agency to supervise both bank and nonbank lenders. While the Dodd Frank Act did not assign enforcement of the Military Lending Act to CFPB, the agency has signed an agreement with the legal officers for the Services to cooperate and CFPB's supervision manual for small dollar lending requires CFPB to notify other agencies when violations of the MLA are uncovered.

Following the 2006 Congressional debate and bi-partisan support for the MLA's 36 percent rate cap, bills were introduced in both houses of Congress to impose a federal usury cap on all credit to benefit all borrowers. Parallel bills were introduced in the 111th Congress by Senator Durbin (S. 500) and by Rep. Jackie Speier (H. R. 1608). While these bills have yet to be enacted, the post-MLA period saw heightened attention to the cost of credit. Unfortunately CFPB was denied the authority to set a federal usury cap, leaving restraint on the cost of credit to state regulators who are in a position to enforce the MLA with non-bank lenders.

At the state level, Congressional action to ban payday and car title lending for military families and to enact a 36 percent inclusive rate cap on lending has been influential. No state has enacted legislation making payday or car title lending legal after 2005. While a few states have enacted laws that applied to these products since the MLA passed, these products did not continue their march to legal recognition at the state level.

Since the MLA became law, voters in three states have overwhelmingly voted for ballot initiatives to impose the same or lower rate caps on one or more forms of small dollar loans. In 2008 voters in Arizona rejected the payday loan industry's Prop 200 by a 60 to 40 percent vote margin. As a

result the state's 36 percent small loan rate cap remains in effect while single payment triple-digit payday loans ceased to be authorized when the payday loan law sunset in 2009. Triple-digit rate car title loans are still authorized in Arizona and the state legislature rejected a bill to empower state regulators to enforce the Military Lending Act.

Ohio voters also overwhelmingly voted in favor of the legislation creating a 28 percent rate cap for payday loans. While that vote was a resounding rejection of predatory payday lending, Ohio lenders continue to exploit loopholes in other small loan laws to make triple-digit rate loans.

In 2010, voters in Montana passed a ballot initiative to set a 36 percent rate cap on all forms of small loans, including payday, car title, and installment lending. Advocacy materials for the 2012 Missouri ballot campaign to cap all small loan rates at 36 percent APR per the Military Lending Act.

A key advocacy point in all state legislative and ballot campaigns has been that states should provide all Americans with the protections against predatory lending that Congress enacted for servicemembers and their families.

Recommendation: The protections of the Military Lending Act should be extended to all Americans in order to restrain usurious lending and to safeguard key family assets, including funds in deposit accounts, vehicles, and tax refunds and benefits distributed by tax credits.

XIV. Access to Relief Society Assistance and Better Financial Options

A factor in the general success of the Military Lending Act to curb predatory lending to servicemembers is the availability of emergency assistance from charities that serve each branch of the Services, promotion of building an emergency savings fund, and access to responsible small dollar loans from financial institutions on or near bases.

A key fact to keep in mind when trying to quantify whether the funds loaned by relief societies and responsible credit available to young servicemembers are sufficient to supplant prohibited payday and car title lending is that only a fraction of payday loan volume goes to meeting borrowers' needs. According to a study by the Center for Responsible Lending, seventy-six percent of payday loan volume is caused by "churn" when consumers borrow again before their next payday because they could not afford to repay the initial loan.³⁰⁰ Car title loan renewals are common.

Military charities provide a great service by making small interest-free loans or grants available for emergency assistance, typically to active-duty servicemembers and retirees. These programs include:

Coast Guard Mutual Assistance provided \$4.6 million in assistance to 6,430 cases in 2010, with \$3.97 million provided in interest-free loans plus \$232,000 in quick loans. In the last five years, Coast Guard Mutual Assistance issued \$20.4 million in interest-free loans. Their Quick Loan Program is specifically intended to take the place of predatory payday lenders. Since the Quick Loan program began, it has provided 1,050 loans, with loans up 8.5 percent in 2010 over the prior year.³⁰¹

Army Emergency Relief (AER) in 2011 provided \$69.4 million in No-Interest Loans and Grants to 62,000 Soldiers and their families.³⁰² AER funds are distributed by Commanders for emergency financial assistance, are conducted within the Army structure, and are provided either as an interest-free loan, a grant, or a combination. The bulk of assistance goes to active-duty Soldiers. For example of the \$77.6 million in financial assistance in 2010, \$58.5 was provided to active-duty personnel. Needs covered include payment of rent, essential car repair, and emergency travel. These categories make up almost three-quarters of all emergency assistance provided. AER's Commander's Referral Program enables Company Commanders and First Sergeants authority to approve loans up to \$1,000.³⁰³

Air Force Aid Society created the Falcon Loan as a streamlined process for assisting with financial emergencies. Airmen do not have to go through commanders or supervisors to be granted the Falcon loan. The loans now up to \$750 are available on Air Force bases with an Airman & Family Readiness Center, are interest-free, and must be repaid by allotment within three to ten months.³⁰⁴ Air Force Aid Society funds can be used for basic living expenses,

³⁰⁰ Leslie Parrish and Uriah King, "Phantom Demand: Short-term due date generates need for repeat payday loans, accounting for 76% of total volume," Center for Responsible Lending, July 9, 2009, p. 3, available at <http://www.responsiblelending.org/payday-lending/research-analysis/phantom-demand-final.pdf>

³⁰¹ Coast Guard Mutual Assistance, "2010 Annual Report," p. 2, 4. www.cgmahq.org

³⁰² Army Emergency Relief, "Quick Summary: 2011 Program Results." Add web link

³⁰³ Army Emergency Relief, "Annual Report 2010." www.aerhq.org

³⁰⁴ www.afas.org/Assistance/FalconLoanQA.cfm, viewed March 29, 2012.

vehicle expenses, emergency travel, medical or child care expenses, not discretionary purchases.³⁰⁵ In 2011, \$9 million in emergency assistance was provided to Airmen in interest-free loans and grants to help with 17,792 cases.³⁰⁶

Navy-Marine Corps Relief Society (NMCRS) initiated the Quick Assist Loan Program (QAL) in 2008 as an alternative to short term high interest loans. The interest-free loans are for up to \$300 and are repayable through allotments within ten months. QALs provide help with basic living expenses, vehicle or transportation expenses, or to assist during family emergencies. Sailors or Marines can have up to two QALs in a 12-month period and the first must be paid in full before another is available.³⁰⁷ In 2010, the NMCRS provided \$15.1 million in Quick Assist Loans to 51,309 clients through its nearly 250 offices.³⁰⁸ QALs are made by NMCRS staff without involving commanders.

The DoD Report to Congress in 2006 described a long list of available credit options from banks and credit unions and reported to Congress in 2008 that these options remained available. For example, the Pentagon Federal Credit Union has provided its ARK loan for the last eight years. The ARK loans provides up to \$500 in emergency money at a flat fee of \$5. Borrowers can roll over this loan without additional charge for five times but members requesting loan renewals must go to free credit counseling. PFCU's foundation covers the losses for twelve other defense credit unions who participate in the ARK loan program.³⁰⁹

Military Saves is a social marketing campaign led by Consumer Federation of America in cooperation with the Department of Defense.³¹⁰ Saves started signing up servicemembers who pledged to become savers in 2007. Since it started in 2007, more than 99,000 individuals have enrolled as savers. Military Saves is the one key "financial action" that individual military members and their families can take to begin their journey towards financial freedom and stability. Through the principles of social marketing, Military Saves promotes change in personal financial behavior. More than 200 defense credit unions and military banks participate in activities to promote personal financial readiness as part of Military Saves which is now a part of the community standards (adequate personal savings, manageable or no consumer debts, and financial literacy) that DoD strives to establish for all military families.

In 2011 Military Saves counted 22,117 military personnel, staff and family members as taking the "Military Saves Pledge" during the months of January, February, and March. As a result, there are now over 100,000 military personnel and family members who have taken the Savers Pledge. One bank reported opening 319 savings accounts with balances totaling \$327,332 in 2011. In addition almost seven hundred certificates of deposit totaling \$174,000 in deposits were opened.³¹¹

³⁰⁵ Air Force Aid Society Assistance Guide, September 2011.

³⁰⁶ Air Force Aid Society, 2011 Fact Sheet, www.afas.org

³⁰⁷ Navy-Marine Corps Relief Society, "Quick Assist Loan Program," www.nmcrs.org/quickassist.html, viewed March 29, 2012.

³⁰⁸ Navy-Marine Corps Relief Society, "2010 Annual Report," p. 8.

³⁰⁹ Testimony, Frank Pollack, President, Pentagon Federal Credit Union, Senate Banking Committee hearing, November 3, 2011.

³¹⁰ www.militarysaves.org

³¹¹ Andia Dinesen, Military Saves, electronic communication, November 14, 2011. www.militarysaves.org