

Comments

Of

Center for Responsible Lending  
Consumer Federation of America  
Consumers Union of U.S., Inc.  
National Association of Consumer Advocates  
National Consumer Law Center (on behalf of its low income clients)

On

Request for Comments

Implementation of Limitations on Terms of Consumer Credit Extended to  
Service Members and Dependents

72 Federal Register 73336-7 (December 27, 2007)

DOD-2006-OS-0216

Submitted

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## **Introduction**

The consumer organizations filing these comments submitted detailed recommendations in February and June of last year to the Department of Defense on how to get maximum consumer protections from the Military Lending Act (MLA).<sup>1</sup> We were disappointed that the initial set of regulations covered only three forms of consumer credit subject to the 36 percent rate cap and fair lending requirements, and defined those three narrowly, creating a road map for how to reshape products to evade the law. Already, we are finding lenders that have changed their terms just enough to escape the MLA rules. Major credit providers are essentially uncovered. While not explicitly excluding banks, the initial DOD rules failed to cover credit cards, bank lines of credit, home equity loans, or bank overdraft loans.

We appreciate the Department's request for further input on expanding regulations to more products. We strongly support giving active-duty Service members and their families the comprehensive protections enacted by Congress. Uniform rules for all forms of credit (excluding mortgages and loans secured by property) will benefit Service members, simplify consumer education and enforcement, and provide a level playing field to the credit industry.

Our comments briefly discuss implementation of the current regulations, then supplement our February 5, 2007 and June 11, 2007 filings regarding open-end credit and credit cards, installment loans, and bank overdraft loans.<sup>2</sup> We also make suggestions for enforcing the current ban on Internet payday loans to covered Service members. Finally, these comments address developing beneficial financial practices to supplant predatory loans for Service members who struggle financially from payday to payday.

## **Covered Loans and Restructuring**

In less than five months from implementation of the MLA protections, it is too soon to know whether covered lenders are fully complying with the law and to what extent covered products have been restructured to evade rate limits and consumer protections. State credit regulators who inspect state licensed payday and title lenders are better positioned to report on early compliance and whether lenders who limit their field of customers to Service members are complying with state credit regulations. Where the Department's regulations are focused on specific predatory products, it appears that the new law is working to protect Service members. There are exceptions, however, especially where states do not closely regulate and supervise lenders such as title pawn operations.

## **Refund anticipation loans:**

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<sup>1</sup> John Warner National Defense Authorization Act for Fiscal Year 2007, § 670, codified at 10 U.S.C. § 987.

<sup>2</sup> Documents referred to in these comments are on file with Consumer Federation of America.

The initial Department rules<sup>3</sup> defined tax refund anticipation loans (RALs) as a covered product. Typically RAL costs exceed the 36 percent rate cap when all fees are included in the calculation. This tax season H&R Block is making refund anticipation loans to covered Service members at about 137 outlets located near major bases. The loans are provided by MetaBank and cost borrowers 36% annual interest since MetaBank waives the account set up fee. The loan proceeds can be delivered through direct deposit to the borrower's bank account for no additional cost or can be loaded onto the ANEW prepaid debit card issued by Block Bank. The Block loan contract exempts military personnel from the mandatory arbitration clause that otherwise applies to RALs from MetaBank. The contract claims South Dakota as the applicable state law, although the loans are issued around the country. Block's "Additional Terms" authorize the tax preparer to share tax return and loan information with other banks that provide RALs.<sup>4</sup>

Jackson Hewitt has not offered Service members a loan product secured by the borrower's anticipated tax refund. Instead, banners in tax preparation offices and an advertisement on Jackson Hewitt's website home page direct clients to Pioneer Military Lending to apply for an installment loan. Those installment loans are not subject to the Department of Defense regulations defining covered products and do not have a rate cap or the other protections of the MLA.<sup>5</sup> The Jackson Hewitt/Pioneer Military Lending page offers loans of \$500 to \$10,000 which are not secured by tax refunds. The Pioneer home page includes no information about the cost or terms of loans.

### **Car Title Loans:**

The Military Lending Act bans loans secured by the title to a borrower's vehicle and the DOD regulations classify closed-end title loans of 181 days or less as a "covered" form of credit. In some states, title lenders are not state licensed or supervised. Following implementation of the new regulations, CFA received copies of title loan contracts from Georgia that appear not to comply. Georgia Auto Pawn, Inc. in Kingsland, Georgia charged 304.17% APR for a \$318 one-month title loan to a Sailor from Kings Bay. The finance charge was \$79.50 plus financing of an \$18 filing fee for total repayment \$397.50. The contract included a mandatory arbitration clause, prohibited by the Military Lending Act. A Sailor based in Florida paid \$182.19 for a \$728.73 title loan from Georgia Auto Pawn in December at a 304.17% APR. The one-month loan was secured by title to a Chevy Blazer.

The MLA rules from DOD defined a covered title loan as closed-end credit, failing to protect all Service members in Virginia and Kansas, since title loans in those states are designed as open end lines of credit to evade state consumer protections. The definition covered closed end title loans of 181 days in duration, leaving uncovered title loans that

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<sup>3</sup> 32 CFR 232.3

<sup>4</sup> H&R Block Military RAL contract, 1/18/08, on file with CFA

<sup>5</sup> [www.jacksonhewitt.com](http://www.jacksonhewitt.com), visited 1/18/08, linked to <http://landing.pionermilitaryloans.com/affiliateLanding>.

extend to longer periods. Four states that authorize title loans set no maximum loan term, making it possible for loans to exceed the 181 day definition.<sup>6</sup>

*Recommendation:* The Act prohibits taking title to a car as security except in connection with purchase money credit. All non-purchase money loans secured by the title to a vehicle should be covered by the Military Lending Act regulations, including open-end loans and loans of any term.

### **Payday Loans:**

Payday lending was a driving force behind passage of the Military Lending Act. The heavy toll caused by extremely high interest rates, short repayment term, check-holding, and the resulting debt trap caused by payday lending was underscored in the case of a Fort Lewis, WA soldier who was sentenced in December for robbing a Tacoma bank to pay off thousands of dollars in payday loans before being deployed to Iraq.<sup>7</sup>

While large payday lenders announced they had stopped making loans to Service members, only systematic state regulatory compliance examinations can document whether compliance is universal. Early signs are encouraging. Advance America's President and CEO issued a letter to Service members stating that new loans would not be issued effective October 15, 2007 and the lender made available the Covered Borrower Identification Statement to screen applicants. Money Tree's credit rejection form letter now includes this reason: "We do not offer a loan on the terms and conditions required by federal law for loans to members of the military, their spouses or dependents."<sup>8</sup> Money Tree also urges military borrowers to file complaints about federal protections with state small loan regulators.<sup>9</sup> The Check Into Cash website includes the covered military borrower screening form. Informal reports from financial counselors indicate a drop in clients with payday loan debt problems.

The narrow definition of a covered payday loan limits protection to loans of 91 days or less. Payday lenders in Illinois have restructured their loans to avoid the Illinois Payday Loan Reform Act, which defines a covered loan as one at or under 120 days. The Governor of Illinois wrote to Members of the Department Of Defense Authorization Conference Committee in 2006, describing the "aggressive battle" waged by payday lenders in Illinois to circumvent consumer protections. "As soon as we instituted new payday loan restrictions that limit interest rates and apply to loans with terms of up to 120 days, the industry began offering loans with terms of 121 days so they could resume charging interest rates of 500% or more."<sup>10</sup> None of the "installment" payday loans made in Illinois fit the narrow Department rules. Last year the New Mexico legislature passed a law to restrain payday lending without capping rates for installment loans.

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<sup>6</sup> Arizona, Idaho, Missouri, and Utah. See, Consumer Federation of America, "Driven Into Debt: CFA Car Title Loan Store and Online Survey," Appendix B, November 2005.

<sup>7</sup> "Prison for bank-robbing soldier," The Associated Press, posted at [www.msnbc.msn.com](http://www.msnbc.msn.com) on 12/9/07.

<sup>8</sup> Money Tree form letter, dated 1/3/08, on file with CFA.

<sup>9</sup> Money Tree military form letter, on file with CFA.

<sup>10</sup> Press Release, Governor Rod Blagojevich, Illinois, "Governor Blagojevich calls on Congress to pass federal payday lending protections for Military Personnel," September 7, 2006.

Advocates report that lenders have switched to making “installment” loans to evade the modest rate cap that applies to payday loans.

*Recommendation:* The Military Lending Act prohibits loans based on personal checks held for future deposit or on electronic access to borrowers’ bank accounts. The Department should remove any limiting factors in definitions of payday loans in order to extend that protection to all lending on terms that violate the MLA.

### **Mapping Case Study on Impact of MLA Payday Loan Rules**

While there is considerable anecdotal evidence that payday lenders and other predatory loan sources are closing up shop near military bases around the country, such closures are not yet readily discernible from state licensing agencies. Several states with large military installations do not have a set expiration date on licenses issued to payday lenders, and therefore will only be able to note a closure when the shop owner fails to renew his or her license. Washington and Virginia appear to fall into this category. Other states, such as Colorado, renew licenses each year, but have not yet begun the renewal process for 2008. The effect of the Military Lending Act should become clearer once the new rosters of licenses are issued for such states later this year. Other states, such as Texas and Hawaii, either fail to license payday lenders or obscure data in such a way to make measuring the impact of legislative changes in a systematic fashion nearly impossible at this point in time.

Nevertheless there is some data to suggest that regulations have discouraged payday lending near bases. Since the Graves-Peterson report was first issued in 2005, there has been significant news coverage of the issues surrounding loan sharking to troops. High profile news coverage, the Department’s Report to Congress, and opposition from local military leaders seems to have undermined payday lending near military bases. While the number of payday lenders has increased in some parts of the U.S., it appears that near military bases the number of shops has decreased. Some of the best data is available from California.

Data from the state of California, while not ideal, appear to offer an early glimpse into the effect of the recent legislation on military communities. Statewide there has been a slight *increase* in the number the payday lenders since 2004, reaching a peak perhaps in 2006. Between January 2007 and January 2008, about 126 shops have closed (about 5%). A significant number (27) of those closures have been near military bases.

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. Similar rates of closure could be found in Twenty-nine Palms where in 2004 there were 7 payday lenders. Last year there were 4 and now (2008) only 3 are licensed. California ZIP code

92105, adjacent to Naval Station San Diego had 12 payday lenders in 2004, 7 in 2006 and only 5 in January 2008, a 58% reduction in total numbers.<sup>11</sup>

Attached is a map showing the pattern of change for Oceanside, California since 2004, the first year data was collected by Steven Graves of California State University, Northridge. Payday lenders operating during late 2004 can be compared against the pattern in January 2007 and January 2008. (Appendix A)

### **Online Payday Loans**

Early in 2008, Consumer Federation conducted a small review of online payday lenders to see if websites are screening loan applicants for military status. CFA staff used Google.com to search for the term: “payday loans” military apply. We clicked on all lenders that appeared on the first four pages of search results, including the sites that paid for placement as advertisements, since consumers tend to select websites that rank high in search results. CFA also searched for the term: “payday loans” and clicked on the top sponsored links and search results on the first page to see if sites without a military search term asked application questions about active duty military status. We looked for questions in the initial application to see if military or dependent status was requested. For multi-step applications that required entry of Social Security numbers, surveyors did not provide that personal information to proceed. Therefore, it is possible that online applications eventually ask if a potential borrower was active duty military. CFA was not able to determine if an application indicating that the borrower was active duty military or a dependent would be rejected for a loan.

### **Findings:**

Military payday loan search: After eliminating search results that were articles or general consumer information, CFA visited thirty sites that offered loans. Some of these sites were referral sites that gather applications that are then put up for bid to actual lenders; some were essentially listings of other web addresses for payday loans, and some appeared to be actual payday lenders.

Several of the search “hits” for payday loans and military linked to installment loan sites that advertised loans to the military, including five that linked to Pioneer Military Lending. One site posted this message: “Due to restrictive federal legislation, we are no longer able to offer military personnel (or their immediate family) our short-term loans. As a result, we were not able to approve your loan request. We appreciate all you do for our country, and we regret not being able to assist you.”<sup>12</sup>

Thirteen of these thirty sites either asked applicants if they were active duty military and/or dependent or stated that the site no longer made loans to Service members.<sup>13</sup> CFA

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<sup>11</sup> Analysis provided by geographer Steven Graves, California State University at Northridge

<sup>12</sup> [www.bestcashadvance.com/Militaryredirect.aspx?LNo...](http://www.bestcashadvance.com/Militaryredirect.aspx?LNo...) Visited 1/28/08

<sup>13</sup> [www.LPaydayLoan1600.com](http://www.LPaydayLoan1600.com)  
<http://cashbackpayday.com>

also conducted a Google search for “payday loans.” Of the eleven lender or referral sites that were either top of the page sponsored links or search results, only three asked if applicants were active duty military or dependents.<sup>14</sup>

In the “military payday loan” search, applicants who clicked “yes” to the application at [www.nationalfastcash.com](http://www.nationalfastcash.com) “ARE YOU a regular or reserve member of the Army, Navy, Marine Corps, Air Force, or Coast Guard, serving on active duty under a call or order that does not specify a period of 30 days or fewer (or a dependent of such member)” could click on a link for more information. The following statement asked for negative check off on military status:

#### NationalFastCash.com Covered Borrower Identification Statement

Effective October 1, 2007, Federal law provides important protections to active duty members of the Armed Forces and their dependents. (See section 32 CFR Part 232-Limitations on Terms of Consumer Credit Extended to Service Members and Dependents). To ensure that these protections are provided to eligible applicants, we require you to acknowledge that you **do not** (emphasis added) fall into either of the two categories below:

YOU ARE NOT a regular or reserve member of the Army, Navy, Marine Corps, Air Force, or Coast Guard, serving on active duty under a call or order that does not specify a period of 30 days or fewer.

OR

YOU ARE NOT a dependent of a member of the Armed Forces on active duty as described above, including the member’s spouse, the member’s child under the age of eighteen years old, or an individual for whom the member provided more than one-half of your financial support for 108 days immediately preceding today’s date.

**WARNING: IT IS IMPORTANT TO FILL OUT THIS FORM ACCURATELY. KNOWINGLY MAKING A FALSE STATEMENT ON A CREDIT APPLICATION IS A CRIME.<sup>15</sup>**

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[www.payday-today.us](http://www.payday-today.us)  
[www.cashadvanceguide.org](http://www.cashadvanceguide.org)  
[www.credit.com/ufg/credit.com/cash\\_advance](http://www.credit.com/ufg/credit.com/cash_advance)  
[www.lowestloanrates.net](http://www.lowestloanrates.net)  
[www.PaydayPerfect.com](http://www.PaydayPerfect.com)  
[www.nationalfastcash.com](http://www.nationalfastcash.com)  
<http://Loans.USA-Services-Guide.com>  
[www.citycashloans.com](http://www.citycashloans.com)  
[www.bestcashadvance.com](http://www.bestcashadvance.com)  
[www.piggybankcashloans.com](http://www.piggybankcashloans.com)  
[www.lowestloanrates.net](http://www.lowestloanrates.net)

<sup>14</sup> Search conducted 2/21/08 by CFA.

<sup>15</sup> [http://www.nationalfastcash.com/?page=other\\_military\\_definition](http://www.nationalfastcash.com/?page=other_military_definition), visited 2/20/08

On the home page of CashBackPayday.com, the statement is made “Effective Jan 2<sup>nd</sup> 2007: We will no longer accept applications from Active Duty Military Personnel and their spouses and those who don’t have direct deposit.”<sup>16</sup>

In this small sample only about one third of payday loan websites even initially ask if loan applicants are covered Service members. Although it is not clear that an affirmative answer would mean compliance with the Department’s regulations, it is reasonable to conclude that sites that do not ask about military status are not complying with the Military Loan Act protections.

### **High Cost Credit That Should Be Covered by DOD Regulations**

#### **Overdraft Loans**

In our June comments, we provided examples of Service members who were trapped in triple-digit debt by overdraft loans, the bank equivalent of payday lending, and urged the Department to apply MLA protections. Efforts to avoid overdraft fees are one of the factors that may drive Service members to use payday loans. We strongly urge the Department to extend the 36 percent rate cap to loans made by banks that permit and encourage transactions to overdraw the account.

Military personnel are required to have bank accounts in order to receive direct deposit of their pay. This exposes all Service members to the high cost and unfair repayment terms of bank overdraft loans. Most major financial institutions automatically enroll customers in a fee-based overdraft loan program without their express consent and without Truth in Lending Act disclosures when they first open a checking account. Under these systems, the bank or credit union generally pays the customer’s checks, debit card transactions, and ATM withdrawals when the customer’s account lacks sufficient funds, without warning consumers at the ATM or POS terminal about the fee or giving them the option of canceling the transaction. When the customer's next deposit is made, the financial institution debits the amount of the overdrafts, plus a fee averaging \$34 for each incident.<sup>17</sup>

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<sup>16</sup> <http://cashbackpayday.com>, visited 2/20/08

<sup>17</sup> CRL conducted an analysis of the checking account activity for more than 5,000 households which participate in the Ultimate Consumer Panel from Lightspeed Research. An examination of overdraft fees charged by a variety of banks and credit unions revealed an average fee of \$34 charged each time a consumer’s account balance went below zero. For more details, see Eric Halperin, Lisa James, and Peter Smith. *Debit Card Danger: Banks offer little warning and few choices as customers pay a high price for debit card overdrafts*, Center for Responsible Lending (January 2007). Available at <http://www.responsiblelending.org/pdfs/Debit-Card-Danger-report.pdf>.



Overdrafts are increasingly triggered by small dollar debit card transactions; on average, the typical debit card transaction that spurs a \$34 overdraft fee is for a \$20 purchase.<sup>18</sup> Essentially, when a consumer is overdrawn, their debit card functions as an extremely high-cost credit card. Overall, consumers pay \$17.5 billion in overdraft fees every year for \$15.8 billion in credit extended to them for only a few days.<sup>19</sup>

Example: An E-5 Sailor based in Maine incurred \$430 in overdraft fees and \$140 in insufficient funds fees on a series of small checks and debit card purchases over a one-week period. Instead of rejecting debit transactions that exceeded the balance in the bank account, the bank permitted the expenditures, then charged \$35 for each extension of credit. Debit card purchases that overdrew the account were for \$10.29, \$6.76, \$3.19, \$23.38, \$13.75, \$11.09, \$6.75, \$3.55, \$18.76, \$10.04, \$6.31, \$4.91, \$7.20.... in no case was the extension of overdraft credit as much as the overdraft loan fee of \$35.<sup>20</sup>

## Methodology

To quantify the impact of overdraft loans on Service members, the Center for Responsible Lending used data from a consumer panel tracked by Lightspeed Research Inc. CRL's analysis includes data for 5,681 households whose transaction-level banking account activity was electronically captured. The dataset contains 18 months of data on 3,279,522 transactions.<sup>21</sup>

CRL identified all panelists who receive their income by direct deposit from the Defense Finance and Accounting Service (DFAS). DFAS is responsible for paying Federal civilian employees, military service members, and military retirees and annuitants. These panelists had 228 transactions resulting in an overdraft fee averaging about \$34 charged.

## Findings

The 228 overdrafts to DFAS payees were triggered by different types of transactions:

- 1) less than one percent (0.4%) were caused by an ATM withdrawal

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<sup>18</sup> Eric Halperin, Lisa James, and Peter Smith. *Debit Card Danger: Banks offer little warning and few choices as customers pay a high price for debit card overdrafts*, Center for Responsible Lending (January 2007). Available at <http://www.responsiblelending.org/pdfs/Debit-Card-Danger-report.pdf>

<sup>19</sup> For a discussion of these estimates and how they were calculated see Eric Halperin and Peter Smith. *Out of Balance: Consumers pay \$17.5 billion per year in fees for abusive overdraft loans*, Center for Responsible Lending (July 11, 2007). Available at <http://www.responsiblelending.org/pdfs/out-of-balance-report-7-10-final.pdf>.

<sup>20</sup> Bank print-out, on file with CFA.

<sup>21</sup> CRL conducted an analysis of the checking account activity for more than 5,000 households which participate in the Ultimate Consumer Panel from Lightspeed Research. An examination of overdraft fees charged by a variety of banks and credit unions revealed an average fee of \$34 charged each time a consumer's account balance went below zero. For more details, see Eric Halperin, Lisa James, and Peter Smith. *Debit Card Danger: Banks offer little warning and few choices as customers pay a high price for debit card overdrafts*, Center for Responsible Lending (January 2007). Available at <http://www.responsiblelending.org/pdfs/Debit-Card-Danger-report.pdf>.

- 2) 3% were caused by bank fees
  - 3) 15% were caused by ACH transactions, which are usually online bill payments
  - 4) 41% were caused by a debit card point of sale (POS) transaction, typically when a debit card is used at a checkout counter
  - 5) 42% were caused by checks
- (numbers rounded, may not add to 100.0%)

Those overdrafts caused by ATM withdrawals and debit cards are particularly problematic for two reasons: (1) many of these transactions could have been declined by the bank at no cost to the consumer, rather than allowing these transactions that put their balance below zero to go through; and (2) because the fee is the same (\$34, on average) no matter how much the transaction is for, people who overdraw by using their debit card at the ATM or checkout counter are particularly hard hit by these fees (see table below).

Median Fee-Based Overdraft Loan Cost by Trigger Type (for entire consumer panel)

	Fee Amount	Transaction Amount	Overdraft Loan Amount	Fee per Dollar Borrowed
Debit Card POS	\$34.00	\$20.00	\$16.46	\$1.94
ATM	\$34.00	\$40.00	\$40.00	\$0.78
ACH/Electronic Transaction	\$34.00	\$29.14	\$27.95	\$0.98
Check	\$34.00	\$60.00	\$41.38	\$0.73

While the overdrafts of younger, enlisted military members could not be identified, this group likely bears the highest cost for overdrafts, because consumers age 18-24 tend to use their debit cards more frequently and for smaller purchases. Thus, if funds in their account are low, they are at greater risk of overdrawing through a small transaction paid for with a debit card.

Recommendations: The Defense Department should include fee-based overdraft loans such as the ones described above as part of the Military Loan Act “covered credit;” however, better overdraft policies aimed at military families are possible without a change in the regulations under this law.

For example, the Defense Department contracts with a bank to provide military banking services at installations around the world to members of the military. As part of its process in awarding a contract to a bank, it could require that bank to provide a low-cost overdraft line of credit (about 18% APR or less, generally) to all military members. To borrow \$20 to cover an overdraft, a consumer would pay only about 30 cents with a linked line of credit,<sup>22</sup> compared to the \$34 overdraft fee in a high-cost overdraft loan program. The FDIC has been encouraging banks to adopt small dollar loan programs, and these lines of credit could potentially qualify for CRA credit. The Department should prohibit financial institutions located on military bases from making high cost overdraft loans to Service personnel.

<sup>22</sup> Assumes \$20 is borrowed at 18% APR with repayment in 30 days.

Credit unions and other financial institutions associated with the military could also be encouraged to offer overdraft protection through a lower-cost line of credit instead of automatically enrolling consumers in a fee-based overdraft program.

### **High Cost Credit Cards**

The exclusion of open-end credit as “covered credit” under the initial Department of Defense regulations fails to protect Service members from the high costs of credit cards, which can often exceed 36% when excessive fees and penalty rates are considered. The biennial credit card survey conducted by the group Consumer Action found that credit card penalty rates can be as high as 32% APR,<sup>23</sup> and these rates do not include the effect of fees such as cash advance, balance transfer, or penalty fees. If those fees are included, the APR can easily exceed 36%. For example, consider a consumer who transfers a \$1,000 balance with a 3% balance transfer fee (\$30). If the creditor imposes a 28% APR<sup>24</sup> on the balance transfer, the effective or “fee-inclusive” APR under the Truth in Lending Act is over 70%.

Moreover, we strongly suspect that credit card debt plays a much larger role than payday, auto title or refund anticipation loans do in the financial picture of Service members who have lost their security clearances or otherwise are struggling with unmanageable debt loads. Recent Senate hearings show the devastating impact that high penalty rates can have on consumers’ ability to manage and pay down their credit card debt.<sup>25</sup> A recent Color of Money column by Washington Post writer Michelle Singletary profiles three military families who requested financial coaching to improve their money management skills. All three families had heavy credit card debt loads: The Bathiche family at Fort Meade owed \$27,000 on six credit cards; the Colans owed more than \$30,000 on eight credit accounts; and the Holmeses are described as having accumulated “a lot of credit card debt.”<sup>26</sup>

Service members may be particularly victimized by “fee-harvester” credit cards – products that charge hundreds of dollars in fees and extend minimal available credit – sometimes as little as \$50. The National Consumer Law Center’s recent report on fee-harvester cards featured an example provided by the Navy-Marine Corps Relief Society office in Bremerton, Washington.<sup>27</sup> A sailor was seeking assistance from that office to deal with a credit card she had taken three months earlier from First Premier Bank, with a

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<sup>23</sup> Consumer Action, 2007 Credit Card Survey, Consumer Action News (Spring 2007), available at [http://www.consumer-action.org/news/articles/2007\\_credit\\_card\\_survey](http://www.consumer-action.org/news/articles/2007_credit_card_survey).

<sup>24</sup> Such a situation is not unusual. The plaintiff in *Hauk v. JPMorgan Chase Bank USA, N.A.*, Civil No. 05-00625 (C.D. Cal. 2005) accepted a balance transfer offer of 4.99%, only to be socked with a penalty APR of 28.74%.

<sup>25</sup> U.S. Senate Permanent Subcommittee On Investigations, Hearing On Credit Card Practices: Unfair Interest Rate Increases (Dec. 4, 2007), available at <http://hsgac.senate.gov/index.cfm?Fuseaction=Hearings.Detail&HearingID=509>.

<sup>26</sup> Michelle Singletary, “Enlisting Help in Financial Boot Camp,” *Washington Post*, February 17, 2008, F 1.

<sup>27</sup> Rick Jurgens and Chi Chi Wu, *Fee-Harvesters: Low-Credit, High-Cost Cards Bleed Consumers*, National Consumer Law Center (Nov. 2007), available at <http://www.nclc.org>.

supposed APR of 9.9% and supposed credit limit of \$250. The sailor had only used the First Premier card during the first month to buy \$85 worth of purchases. Yet that \$85 “spending spree” had pushed her over the \$250 credit limit because of huge fees imposed by First Premier. In terms typical of fee-harvester cards, the unwary sailor had, without a single swipe of her card, incurred a \$95 program fee, a \$29 account set-up fee, a \$6 monthly participation fee, and a \$48 annual fee – an instant debt of \$178 and buying power of only \$72.

*Recommendation:* If the Department of Defense is not willing to cover all credit cards under the MLA, it should, at a minimum, cover fee-harvester credit cards. Fee-harvester cards would be defined as any credit card for which 10 percent or more of the credit limit is consumed by fees in the first year for the issuance or availability of credit, such as an annual, account opening, participation, membership, activity, or inactivity fee, or a security deposit for such credit limit. Covering those cards under the MLA would not prohibit them, but it would ensure that the overall interest rate does not exceed 36%. Importantly, the ban on mandatory arbitration for covered credit would also give Service members access to the courts when challenging unfair and deceptive fee harvester cards.

### **Other Open-End Credit and Sale/Leaseback Transactions**

The initial Department of Defense rules excluded all forms of open end credit. In addition to credit cards, that left Service members unprotected from open-end payday and title loans, bank overdraft lines of credit, and bank payday loan-type products. In our June comments, we provided examples such as the Wells Fargo and U.S. Bank direct deposit advance loans that cost over 500 percent annual interest for a one-week advance, the Advance America “Choice” line-of-credit previously offered in Pennsylvania (which remains a model other payday lenders can follow), and potentially sale/leaseback or sale/repurchase transactions. There is no justification for arbitrarily covering some high cost loans while excluding others due to structural features easily manipulated by lenders.

*Recommendation:* The current open-end/closed-end distinctions should be removed from the definitions of covered loans already subject to Department regulations, and high cost credit cards and other forms of open end credit should be subject to the law.

Last February, we urged the Department to prevent vehicle title lenders from engaging in sale-leaseback or sale/repurchase subterfuges now used to skirt state small loan laws and gave examples.

*Recommendation:* The Department should add a definition of “purchase money security interest” to prevent the use of sale/leaseback dodge to evade the rules.<sup>28</sup>

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<sup>28</sup> The definition we recommended in our February 2007 comments was: “Purchase-money security interest” means a security interest in personal property taken in conjunction with a consumer credit transaction that finances the initial acquisition of a specific item of property named in the credit agreement. It does not include transactions in which the servicemember or dependent had previously acquired some interest to the property, even if full legal title had not been acquired. Nor does it include a security interest purportedly taken in any item purchased through a credit arrangement provided for general purposes and not for a specific item of property.

## **Restructured Closed-End Loans to Open End Credit**

One way high cost lenders are evading the protections of the Military Lending Act is by restructuring their products to take advantage of the narrow definitions of covered loans. Since DOD exempted all forms of open-end credit, it is not surprising that high cost lenders have turned into open-end providers. A well publicized case in point is Military Financial. A Military Financial, Inc. “Rapid Cash” loan made just prior to the start of MLA rules to a Mayport, FL sailor cost 713.89% APR for a \$971 loan with \$698.32 in finance charges over four installment payments of \$417.33 each.

As of October 1, Military Financial now advertises a “Rapid Cash Line of Credit” for up to 40% of monthly take home pay with no credit check and 99% approval.<sup>29</sup> Its FAQ web page states: “It is illegal to charge more than 36% for a closed end loan consumer loan (payday loans, title loans, etc.) A Rapid Line of Credit is not a closed end loan. It is a revolving line of credit that allows you to access the available funds in your account at any time.”<sup>30</sup> A North Carolina Service member was loaned \$638 on November 16, 2007 by Military Financial and was charged a \$30 transfer fee and \$117 in finance charges for the month for a new balance of \$785.70. The minimum payment due on December 12 was \$289.90 which would be debited from her account if payment was not made directly to the lender. The APR for this transaction was 584.68%, according to the Line of Credit Activity Statement.<sup>31</sup> While the Navy Times newspaper has stopped accepting advertisements from this high cost lender, the Department of Defense has not closed the loophole being exploited by this lender.

## **Installment Loans**

The Department denied Military Lending Act protections to closed-end loans longer than 91 days in term or to installment loans that did not involve a contemporaneous check/debit authorization. This narrow definition of a “payday loan” resulted in longer term closed-end installment loans being outside the protections of the Military Lending Act. Small loan companies that make installment loans are advertising to Service members. An ad stating “Now Servicing Military Personnel” in the base paper at Naval Air Station, Fallon, Nevada touted loans up to \$1,000 from Sun Loan and Tax Service. Sun Loans is licensed as a lender making loans that cost more than 40%, classified as a “high-interest loan” under Nevada’s credit code. According to a 2005 Sun Loan rate schedule, a \$100 loan repaid in four monthly installments costs \$56 in finance charges and 168% APR. A \$500 loan repaid in eight monthly installments costs \$180 and 54% APR. A \$1,000 loan repaid in twelve months would cost \$404 and 40% APR from Sun Loan. Yet, none of these high cost loans violates current Department rules.

The District of Columbia repealed its payday loan law, effective early in 2008. In an area of Northern Virginia close to both the District and military installations, Illinois-based

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<sup>29</sup> Military Financial, Inc. advertisement in *Navy Times*, p. 41, December 24, 2007.

<sup>30</sup> [www.militaryfinancial.com/Faq.aspx](http://www.militaryfinancial.com/Faq.aspx), visited 1/10/08

<sup>31</sup> Military Financial contracts, on file with CFA.

AmeriCash Loans has opened an installment small loan company and offers “checkbook loans” of \$2,500 or more to anyone with ID, a current pay stub, two current bank statements showing Direct Deposit, a current phone bill, two current utility bills showing proof of residency, a check book and proof of employment.<sup>32</sup> The loans are set at the point above \$2,500 where Virginia’s small loan rate cap of 36% does not apply. AmeriCash was cited by Illinois regulators for charging 521 percent annual interest for loans in 2006.<sup>33</sup> Although we do not have a completed loan contract from the new Virginia store, an AmeriCash installment loan to a Chicago consumer for \$150 with twelve monthly payments and a total finance charge of \$558.48 cost 469.20% APR.<sup>34</sup>

Another high cost installment loan offered through Rent-a-Center rent-to-own stores and online at [www.cashadvantedge.com](http://www.cashadvantedge.com) costs borrowers from 220.16% APR for a 31-day term to 886.43% APR for a 7-day term Signature Loan. Since this closed-end loan does not involve a contemporaneous check held for future deposit, it apparently does not fit the DOD definition of a covered “payday loan.” Borrowers pay \$17.64 to borrow \$100. While the Cash AdvantagEdge generic loan application asks if borrowers are covered military personnel, it is not clear if Signature loans are made to Service members.<sup>35</sup> In Texas, Rent-a-Center operates 115 locations as registered Credit Services Organizations, not as licensed small loan companies subject to the Texas signature loan rate cap.<sup>36</sup>

### **Military Installment Loans Online**

CFA conducted a small study of online military lenders to get a better understanding of the cost and types of installment loans currently being offered to Service members. On January 10, 2008 we searched Google using the term “military loan” which generated 1,080,000 hits. Sponsored links at the top of the page advertised Military Financial, Pioneer Military Loans, and Armed Forces Loans. Sponsored links on the right hand margin of the first page of search results carried ads for American General Finance, US Military Loans, Prosper.com, Military.com, and three general payday loan websites. Search results for the top ten sites listed included Omni Financial, Military Loan Company, Pioneer Military Loans, US Military Lending Corp., and [usmiles.com](http://usmiles.com), which arranges auto financing through US Bank. Details from these websites:

- Armed Forces Loans ([www.armedforcesloans.com](http://www.armedforcesloans.com)) makes loans of \$500 to \$5,000 with up to 36-month terms. Rates are claimed to be “competitive” but interest rates and fees are not disclosed on the site. A borrower won’t know the cost of the loan until she has completed the application form and forwarded a Leave and Earnings Statement, providing the lender with extensive personal and financial information. The answer to the question “How much interest do you

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<sup>32</sup> Postcard from AmeriCash to a DC resident, on file with CFA.

<sup>33</sup> Press Release, “Blagojevich Administration and Attorney General Madigan File Simultaneous Enforcement Actions Against Payday Lender, AmeriCash Fined \$190,000 and Order to Stop Issuing Illegal Loans,” July 6, 2006.

<sup>34</sup> Mary Wisniewski, “This is a wolf in sheep’s clothing,” Chicago Sun-Times, October 16, 2006.

<sup>35</sup> [www.cashadvantedge.com](http://www.cashadvantedge.com), visited 1/16/08. “The Edge Signature Loan –No Check Account, No Problem.” [www.cashadvantedge.com/site/page/pg3068.html](http://www.cashadvantedge.com/site/page/pg3068.html), visited 1/16/08

<sup>36</sup> Email communication from Texas Office of Consumer Credit, 1/16/08, on file at CFA.

charge,” is “The cost of your loan is determined by several factors, your credit report, your cash flow, your income, as well as your credit history with AFL. To determine the monthly cost of your loan you will need to apply online at [www.afl.net](http://www.afl.net), send your LES as an email attachment.... You will receive an email or phone call informing the cost of your loan within 4 business hours of receiving your application and LES. There is no charge or obligation to you.”<sup>37</sup> Armed Forces Loans also advertised in the December 3, 2007 *Navy Times* without disclosing the cost of loans. Instead, AFL promises to “say YES when others say NO, Cash Available TODAY, More Money up to \$5,000, No Credit No Problem.”<sup>38</sup>

- Military Financial, “The Original Military Short Term Lender,” offers a “Rapid Cash Line of Credit,” for up to 40% of monthly take home pay. (This product is discussed further under Open End Credit.)
- Pioneer Military Lending offers loans of \$500 to \$10,000 and claims a high military loan approval rate and fast turnaround. On the Pioneer FAQ page, answers relating to the cost of a loan are uninformative: “Interest rates vary from customer to customer. We consider several factors when determining your interest rate, including your credit history (based on a consumer credit report), your military rank, your years of service, and your debt-to-income ratio. We do not determine an interest rate until you apply online so we can look at your entire credit profile.” The site also explains why the APR is higher than the interest: “The Annual Percentage Rate (APR) is the cost of your loan at an annualized rate. This includes any mandatory costs or fees that are shown on the most recent disclosure statement associated with your loan.... The origination fee is the cost incurred in setting up and servicing your loan.” The site does not disclose either a range of interest rates or the amount of the origination or other fees.<sup>39</sup>
- The Military Loan Company website delivers visitors to the Pioneer Military Loan site as does [4instantCashLoans.com](http://4instantCashLoans.com).<sup>40</sup>
- U.S. Military Loans appears to be a referral site that feeds visitors to other lenders’ sites ([www.usmilitary-loans.com](http://www.usmilitary-loans.com)) including Mili-Loans.com, Pioneer Military Lending, Military Team Building, and Active Duty Loans.<sup>41</sup> Military Cash Loan (<http://militarycashloan.com/>) is another feeder site for Pioneer. This site posted an article explaining the new DOD protections against payday loans and touted its Personal Military Loan as a low cost option, along with relief society programs, and military credit union loans.<sup>42</sup>

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<sup>37</sup> [www.armedforcesloans.com/QuestionAnswers.aspx](http://www.armedforcesloans.com/QuestionAnswers.aspx), visited 1/10/08.

<sup>38</sup> Armed Forces Loans ad, *Navy Times*, p. 57, December 3, 2007

<sup>39</sup> [www.pioneerlending.com/customerservice/faq.cfm...](http://www.pioneerlending.com/customerservice/faq.cfm...) visited 1/10/08

<sup>40</sup> [www.4instantcashloans.com/military.html](http://www.4instantcashloans.com/military.html) visited 1/10/08

<sup>41</sup> [www.usmilitary-loans.com/loan-types/installment/](http://www.usmilitary-loans.com/loan-types/installment/) visited 1/10/08

<sup>42</sup> <http://militarycashloan.com/payday-loan-trap.html>, visited 1/10/08

- Omni Financial ([www.militaryloans.com/index.html](http://www.militaryloans.com/index.html)) makes loans of \$500 to \$10,000 to military personnel. In answer to cost of loan questions, Omni's FAQ states "Our military loan rates will vary depending on several factors such as the amount and length of the loan, current financial obligations and past credit history. Applicants with excellent credit can most likely expect a very competitive rate while those who have had some credit problems will find their rate will be higher. In any case, Omni Financial will work to get your loan approved as fast as possible and offer a competitive rate as compared to other military loan lenders, payday loans and pawn lending."<sup>43</sup> Omni sells credit life, disability and debt cancellation insurance and claims that most customers buy the optional coverage. It is highly likely that the cost of Omni loans, including premiums for credit insurance, would exceed the 36 percent MLA rate cap.
- US Military Lending Corp ([www.usmilitarylendingcorp.com](http://www.usmilitarylendingcorp.com)) makes loans between \$1,000 and \$2,500. Applications are downloaded from the website. No cost information is provided.
- Military Loans ([www.mili-loans.com](http://www.mili-loans.com)) offers loans from \$500 to \$250,000 and provides links to Pioneer Military Lending. The site lists its partners as Air Force Loans, Marine Loans, Navy Loans, Army Loans, Active Duty Loans, National Guard Loans and Active Duty Loan.<sup>44</sup>
- Military Funding USA ([www.loansmilitary.com/military\\_loans.php](http://www.loansmilitary.com/military_loans.php)) loans \$1,000 to \$3,000 to full-time Service members with no credit check or collateral for loans. This Nevada-based lender does not disclose any cost information on the website.<sup>45</sup>
- Only Bank of America Military Bank offered unsecured loans online to Service members with rates and terms clearly posted on the website. Loans up to \$2000 for terms of one to 36 months cost 12.99% APR and loans over \$2,000 cost 10.25% APR, well within the 36% rate cap in the Military Lending Act. Bank of America also offers a Military Bank CreditLine at 11.99% fixed APR and no annual fee.<sup>46</sup>

From this limited review, it is obvious that installment lenders are advertising their loans to Service personnel. Due to limited cost disclosures available prior to application, borrowers cannot comparison shop based on the cost of credit. It is highly likely that these loans cost more than 36 percent Military APR once fees and insurance premiums are included.

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<sup>43</sup> [www.militaryloans.com/faq/index.html](http://www.militaryloans.com/faq/index.html), visited 1/10/08

<sup>44</sup> [www.mili-loans.com/](http://www.mili-loans.com/) visited 1/10/08

<sup>45</sup> [www.loansmilitary.com/military\\_loans.php](http://www.loansmilitary.com/military_loans.php) visited 1/10/08

<sup>46</sup> [www.bankofamerica.com/military/index.cfm...](http://www.bankofamerica.com/military/index.cfm...) visited 1/10/08



## Installment Loan Stores Lend to Service members

Small loan companies are making high cost loans to covered Service members since these longer term loans fall outside the definitions of “covered” credit. High cost installment loans were described in the Department’s Report to Congress and the Military Lending Act clearly was intended to restrain the cost and unfair terms of these loans. Our June comments provided examples of installment loans that would not fit the Department’s narrow definitions. The following examples of installment loans written following October 1, 2007 were provided by counselors and consumer advocates.

Illinois does not cap interest rates for lenders licensed under the Consumer Installment Loan Act (CILA). As noted above, most payday lenders in the state have opted to operate as CILA lenders rather than comply with the Illinois Payday Loan Reform Act. As a result, Service members in Illinois are not protected from triple-digit interest rate loans by either the Department of Defense or Illinois law. An Army reservist from Illinois commented to CFA that it made no sense for the Department of Defense to prohibit high cost refund anticipation loans while not prohibiting installment loans at over 400 percent annual interest to Service members.

- Illinois Consumer Installment Loan Act licensees are located in North Chicago, Waukegan and Zion, Illinois, near Great Lakes Naval Station. For example, A All Financial Services loaned \$250 on January 15, 2008 to a Sailor, charging \$469.80 finance charge for five monthly installment payments totaling \$719.80 and 600% APR. The contract included a \$10 or 5% late payment penalty and secured the loan with a wage assignment (fine print states that the wage assignment can be revoked). Payment was by ACH debits from the Sailor’s credit union account. A second loan from the same lender for \$200 cost \$375.85 in finance charge and 600% APR.<sup>47</sup>
- A Sailor based in Florida borrowed \$1,000 on December 11, 2007 from the website ThinkCash.com. The bi-weekly payments of \$101.54 totaled \$2,941.06, according to a reminder email sent January 12, 2008. The loans were made by First Bank of Delaware, a state-chartered FDIC supervised bank and formerly a bank partner of payday lenders. According to its website, ThinkCash makes loans for \$250 to \$2500. An example of a \$1,250 loan repaid with 36 bi-weekly payments of \$91.66 each costs 171.5% APR. Consumers apply online and receive loan proceeds direct deposited into their bank accounts. ThinkCash compares its loans to online payday lenders whose loans cost 521% to 782% APR. By contrast, ThinkCash says it charges “just \$1 per day per \$100 borrowed (365% APR) for small, short-term loans.”<sup>48</sup>

**Recommendation:** The Department of Defense should add installment loans of any length to the definition of “covered credit.”

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<sup>47</sup> Contract on file with CFA.

<sup>48</sup> [www.thinkcash.com/modules/state/states.aspx](http://www.thinkcash.com/modules/state/states.aspx), visited 2/14/08

## **Enforcing Rules Against Internet Payday Lending**

The Department requested comments on the following issue:

*Oversight and enforcement of the regulation with respect to Internet-based lenders offering credit covered by the definitions in 32 CFR 232.3.*

Online payday lending can be difficult to police since lenders can be located anywhere in the world and borrowers can contact lenders anywhere they have access to a computer and the Internet. In recent years, states from Maine to California have filed charges against online payday lenders for failing to comply with the borrower's home state protections.

The federal district court in Kansas ruled in September 2007 that state regulators can pursue an out-of-state Internet payday lender to enforce Kansas consumer protections. The Court ruled that the Kansas Uniform Consumer Credit Code does not violate the Commerce Clause of the United States Constitution and awarded summary judgment to the State. The Court also found that Quik Payday "solicited" loans from Kansas consumers since it directed e-mail solicitations to Kansas customers and directed Kansas consumers to its website after those consumers were referred by a lead generator.<sup>49</sup>

*Recommendation:* The Department of Defense should enlist the formal assistance of state credit regulators to enforce the regulations implementing the Military Lending Act as they regulate covered lenders under their jurisdiction.

*Recommendation:* The Department could direct all JAG officers, financial counselors, and Armed Forces Disciplinary Control Boards to report all instances of Internet payday lending to state regulators.

Online payday lenders are subject to the state law where the borrower receives the loan, giving state Attorneys General and credit regulators jurisdiction to protect borrowers in their states, regardless of where the online lender is located. But state officials cannot act without evidence that loans are being made in their state.

Internet payday loans are almost always delivered into borrowers' bank accounts and collected by electronic withdrawals from borrowers' accounts via the Automated Clearinghouse. The National Automated Clearinghouse Association recently amended the rules that apply to banks that use the ACH network. These changes should make it easier for banks to identify the entity attempting to extend or collect Internet payday loans from Service members' bank accounts. Effective June 20, 2008, an amendment to the NACHA Operating Rules will require an ACH Originator to clearly identify itself in an ACH entry through the use of a name that is known to and readily recognized by the

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<sup>49</sup>Memorandum and Order at 22, *Quik Payday, Inc. v. Stork et al.*, No. 06-2203-JWL (D. Kan. Sept. 7, 2007).

Receiver.<sup>50</sup> This change is especially important in the online payday loan context as it requires identification of the ultimate payee or payor on the loan when that is not the ACH Originator, which can be the case with non-bank payday lenders.

*Recommendation:* To the extent Internet payday lending to Service members is subject to MLA regulations, the Department of Defense should petition military banks and credit unions to cut off electronic access to Service members' bank accounts by Internet lenders.

DOD might consider a carefully crafted information campaign to strengthen lenders' incentive to comply with the law. Internet payday loans that meet the definition of "covered credit" per DOD regulations are null and void.<sup>51</sup> While we encourage consumers to pay their just debts, Service members should be educated not to pay illegal loans. If online lenders cannot collect from Service members, either because they no longer have direct electronic access into accounts or because Service members exercise their rights to revoke authorization to electronically access their accounts, this lending will dry up.

### **Alternatives to High Cost Credit**

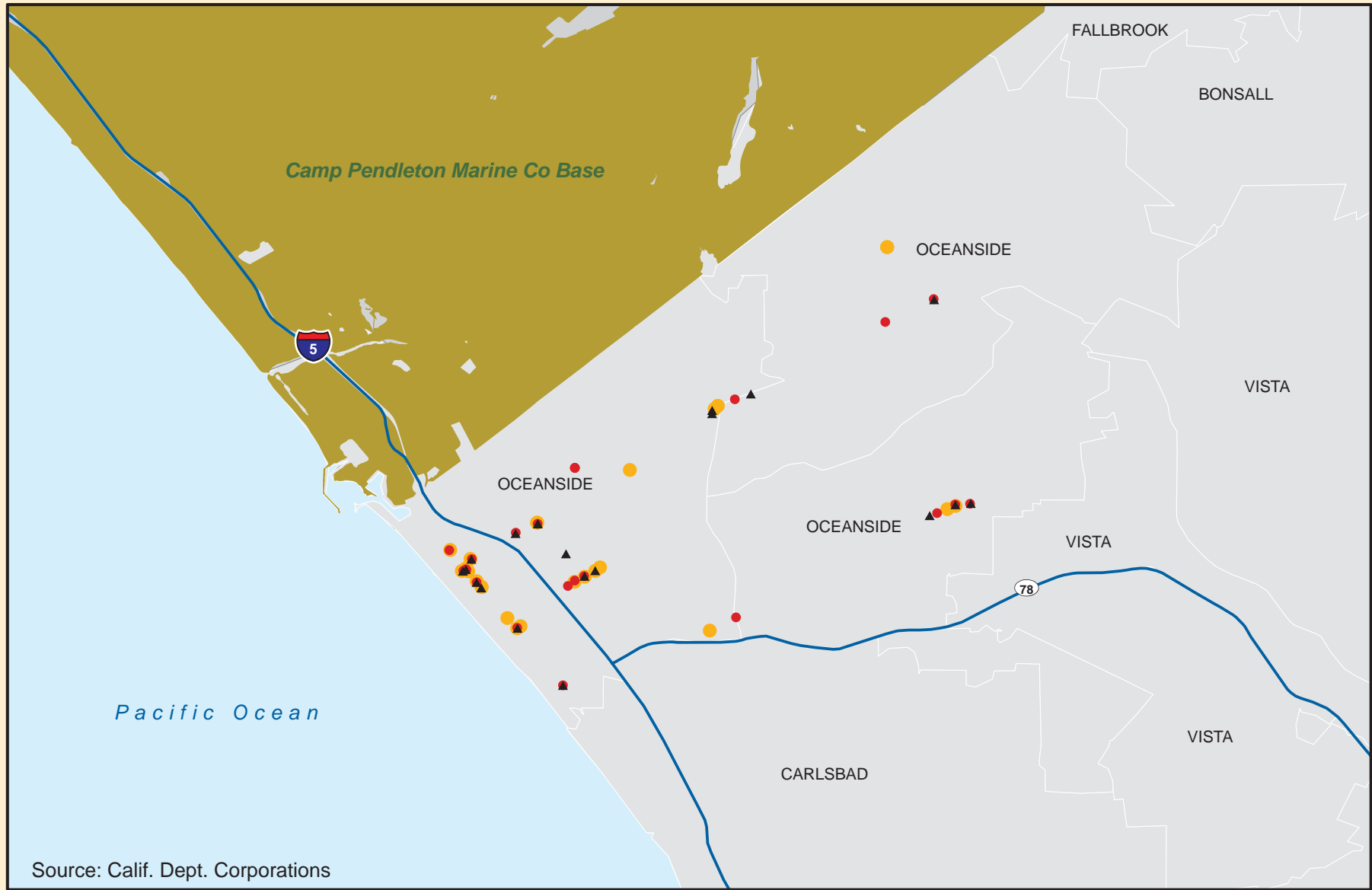
It is not enough to cap rates and prohibit unfair credit terms and practices. Military borrowers need beneficial financial products to foster asset development and access to affordable responsible credit. We applaud DOD's leadership in Military Saves, in cooperation with Consumer Federation of America's America Saves program, which kicks off a nationwide campaign this week. We also note that military charities are now offering access to free loans for emergencies and some military credit unions are combating payday lending through low cost products.

The Department of Defense could consider offering a low-cost cash loan to Service members to provide a safe, affordable employee benefit. A loan program under the control of the Department would be a service and compete with harmful credit options.

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<sup>50</sup> Notice of Amendment to the 2008 ACH Rules, National Automated Clearinghouse Association, Supplement #2-2008, Company name Identification Rule, 2/20/08.

<sup>51</sup> "Any credit agreement, promissory note, or other contract prohibited under this section is void from the inception of such contract." 10 U.S.C. § 987(f)(3).



Source: Calif. Dept. Corporations

- Payday Lenders**
- ▲ January '08
  - January '07
  - Sept. '04

# Payday Lending 2004-2008 Oceanside, CA



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