Consumer Federation of America

November 20, 2013

The Honorable Edward J. Markey
United States Senate
218 Russell Senate Office Building
Washington, DC 20510

Dear Senator Markey:

The Consumer Federation of America (CFA) applauds the introduction of the Military Savings Act of 2013 that would establish a pilot program to develop innovative consumer financial products that encourage savings and wealth-creation among active-duty servicemembers**.** CFA has worked with the Department of Defense (DoD) to create the Military Saves program, which is active on bases throughout the world for all four services, the Reserves, the National Guard and the Coast Guard. Institutional efforts by the DoD to spur the creation of innovative savings tools will not only help increase the financial security of military families, but will reduce demand for abusive, high-cost loans and strengthen military readiness.

A report released by CFA in 2012 found that Military Lending Act has limited the availability of payday and car title loans around military bases, servicemembers are still exposed to many types of high-cost loans that threaten their financial well-being. For military families, having adequate savings that are available for immediate use in case of an unexpected emergency can mean the difference between making ends meet and seeking out a loan that is difficult to pay back in full without considerable financial hardship. Encouraging the creation of widely available automatic savings accounts is one of the most effective methods that Congress and the DoD could take to increase the savings rates of these families.

In addition to facing the same financial challenges that confront most Americans, military families must cope with unique circumstances that can threaten their financial stability: change of station orders; deployments and training that result in lengthy separations; departure from the service without strong civilian job opportunities, and retirement. Knowing that there is money in the bank and that a predatory loan is not coming due allows servicemembers to concentrate on their job during deployment, and not on their finances back home.

We look forward to working with you to enact this important proposal.

Sincerely,

Tom Feltner
Director of Financial Services

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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

by

Consumer Federation of America
May, 2012

Executive Summary: Findings and Recommendations

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 violation problems 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 much great 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.

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.

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.

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.

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.

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.

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.

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 point 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.