

Effect of the Military Rate Cap on Payday Borrowing

Revised from 12/4/09 Internal CRL memo for distribution at the
CFA Consumer Advocate's High Cost Credit & Payday Loan Summit
December 1, 2010

DRAFT

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In response to concerns that predatory lenders were targeting the military and that high levels of indebtedness could threaten security clearances, Congress passed a 36 percent interest rate cap for members of the military in 2006. During the regulation-writing process, it was decided that this rate cap and other protections should apply only to three of the most harmful products affecting military families: payday loans, car title loans, and refund anticipation loans. The rate cap took effect on October 1, 2007.

This brief will offer evidence that the rate cap has been effective in curbing payday loan usage among active-duty members of the military. We will also flag some issues with the military rate cap that make this limit open to evasion by lenders.

I. Effectiveness of the military rate cap

The military rate cap legislation instructed financial regulators and the Department of Defense to define what loans would be covered by the military rate cap. While consumer groups, including CRL, recommended that the cap be applied broadly to as many products as possible, the regulations ended up limiting the rate cap to three high-cost products: (1) payday loans, (2) car title loans, and (3) refund anticipation loans. Because of the product-based focus, definitions for these loans had to be determined, as shown in the table below:

Table 1: Products covered by military rate cap

Payday loans	Car title loans	Refund anticipation loans
Up to \$2,000	--	--
Closed-end	Closed-end	Closed-end
Term of 91 days or less	Term of 181 days or less	--
Based on personal check or electronic access to bank account	Secured by car title	Tax refund goes to creditor to repay loan

Even if these products were offered to service members at a 36% rate, these lenders would have to make more alterations to their products to meet the full requirements of the law. For example, a payday lender making a loan to a member of the military at 36%

would also have to waive their mandatory arbitration clause and would not be able to secure that loan with a personal check or other access to the borrower's checking account. Likewise, even if a car title lender made a loan at 36%, they would not be allowed to use the title to the car as security.

There is ample evidence that this loan cap has resulted in the military receiving fewer of these high-cost loans. The largest payday lender, Advance America, has simply stated that they will no longer offer payday loans to the military.¹ CRL and other groups have found that payday lending applications generally include procedures to identify whether the borrower is subject to a rate cap.²

In addition, some state regulators who track military payday usage have found that the law is being followed. The Washington state regulator reported just 868 military borrowers in 2008, compared with 9,956 in 2007 and 11,650 in 2006.³ When they further analyzed their 2008 data, they found that these 868 military borrowers were in fact inactive, retired or Guard members not covered by the cap.⁴ These trends held true for 2009 Washington regulator data as well.

Similarly, a Colorado regulator found no evidence that current borrowers drew a military salary, as compared to 2.7 percent of borrowers who had military employment in the first six months of 2007 before the rate cap took effect.⁵

The Department of Defense shares similar findings, noting that "...the implementation of and compliance with the [military rate cap] regulation has been effective in curbing payday and vehicle title loans, and has restricted refund anticipation loans obtained by Service members and their families." At the installation level, financial counselors and legal assistance officers report limited use of payday and car title loans, and the Navy Marine Corps Relief Society reporting a drop-off in borrowers needing assistance to deal with payday loans, as shown in the chart below. The loans that do come to the attention of counselors often involved loans to retirees, who are not covered by the rate cap, and pre-service loans taken before the person came into the military.

¹ Press Release: *Advance America Voluntarily Refrains from Providing Advances to Military* (September 25, 2006).

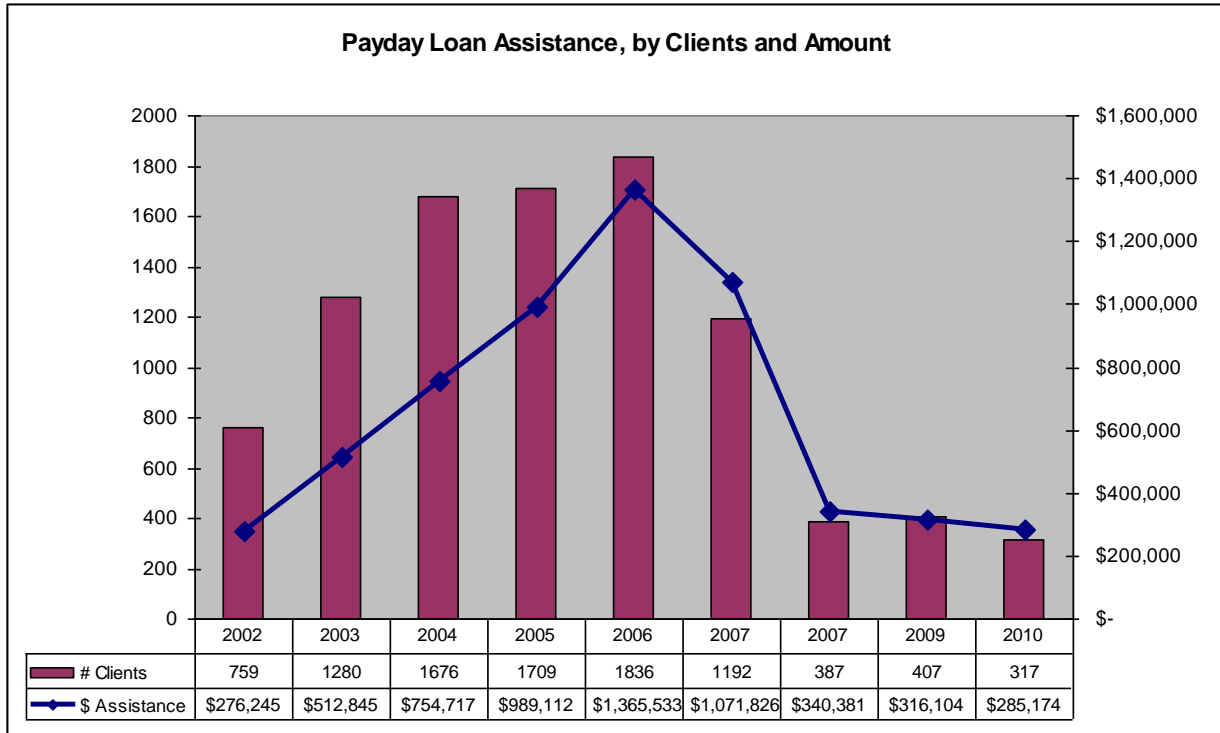
² *Comments on the Implementation on Terms of Consumer Credit Extended to Service Members and Dependents*, Center for Responsible Lending, Consumer Federation of America, Consumers Union, National Association of Consumer Advocates, and National Consumer Law Center (February 25, 2008).

³ *2008 Payday Lending Report*, Washington State Department of Financial Institutions (2009).

⁴ Email correspondence with Alex Ketter, MSB Examinations Supervisor, Washington State Department of Financial Institutions (November 9, 2009).

⁵ Email correspondence with Laura Udis, Administrator, Colorado Uniform Credit Code (November 12, 2009).

Chart 1: Reduction in number of service members and retirees needing payday loan assistance from Navy-Marine Corps Relief Society, resulting in a decrease in needed assistance funds.



*2010 numbers are year-to-date as of 11/28/10

As a result of this decreased use, there is some evidence of payday lending stores located close to military bases closing since the rate cap's implementation. For example, there have been reductions in the number of payday lending storefronts near large military installations in California since the enactment of the rate cap even though the state's overall number of licensees has increased slightly.⁶

II. Evasions of the military rate cap

Because the military rate cap regulations center on three narrowly defined loan products, it is possible for high-cost lenders to make relatively modest changes to ensure the loan product they offer falls outside of the military rate cap's jurisdiction, depending on how a given state regulates small loan products. While one payday lender, Military Financial, appears to have changed its product specifically to get around the military rate cap, other lenders are likely doing this to offer loan products at higher rates than would otherwise be allowed to the general population, and not as a direct result of the Military Lending Act. This is because the military makes up a very small share of overall payday borrowers,

⁶ Analysis of Steven Graves, as summarized in *Comments on the Implementation on Terms of Consumer Credit Extended to Service Members and Dependents*, Center for Responsible Lending, Consumer Federation of America, Consumers Union, National Association of Consumer Advocates, and National Consumer Law Center (February 25, 2008).

and the reputational risk is likely not worth the incremental increase in revenue.⁷ In addition, the fact that the penalties for violating the military rate cap are strong (they are considered criminal violations and result in a nullified contract for the borrower), likely serves as an additional deterrent.

Some examples of how products can be tweaked to evade the military rate cap include:

- ***Offering a high-cost installment loan with a longer loan term.*** In most states, payday lending has been regulated to limit the allowable fees charged and the loan amount, sometimes in conjunction with consumer protections like access to an extended repayment plan. However, in several states without similar or greater limitations on longer-term small loan products, payday lenders simply offer installment products at triple-digit rates. These types of products are now offered in Illinois, New Mexico and South Carolina for terms of 4-12 months.⁸ The fundamental problem of the lack of an underlying rate cap on products other than payday and car title loans is present in at least ten states.⁹ In addition, loans made under the recently revised Colorado payday loan statute will not be covered, since they mandate a 6 month minimum loan term.
- ***Offering an open-ended loan.*** Because the military rate cap only applies to closed-end credit products, lenders can offer open-end products at very high rates if not otherwise regulated by the state. For example, car title lenders offer their product as open-end credit in Kansas and Virginia, where there is no interest rate cap on open-end loans. A nationwide military payday lender, Military Financial, changed its product to an open-end loan after the military rate cap became law.
- ***Offering a car title or payday loan without title or check held as security.*** Rent-A-Center's Cash AdvantEdge financial service centers offer a signature loan that is identical to a payday advance except they do not require the borrower to give a personal check to the lender to hold as security. Because of this, these loan products, which are currently available in 17 states and could expand into others which allow payday loans, are not covered by the military rate cap. Similarly, some lenders are beginning to offer car title loans that arguably are not secured by a free and clear car title. In some cases, the car title loans are merely secured by a copy of the borrower's car registration. It is unclear whether this product will hold up to regulatory scrutiny.

⁷ The payday lending industry estimated that 1-4 percent of its customers were active duty service members before the military rate cap went into effect.

⁸ For example, QC Holdings advertises installment products on its websites which are available in Arizona, New Mexico, and Montana; Cash America's online arm, CashNetUSA, offers a \$750 installment product in South Carolina and Check into Cash is considering an installment loan product for South Carolina as well. Advance America, QC Holdings, and other lenders offer an installment loan product in Illinois.

⁹ Delaware, Idaho, Illinois, Missouri, Montana, New Hampshire, New Mexico, South Dakota, Utah, and Wisconsin lack small loan rate caps on \$500-\$1000 installment loans. See *Small Dollar Loan Products Scorecard*, Consumers Union, National Consumer Law Center, and Consumer Federation of America (2008).

In addition to products that can be tweaked to evade the military rate cap, a wide range of other financial products were not covered by the regulations. These include, among others, high cost credit and debit cards, abusive overdraft fees, auto finance abuses, and loans made by the “traditional military lenders” such as Pioneer and Omni.

III. Conclusion

Evidence suggests that the military rate cap has been successful in protecting active-duty service members and their families from high-cost payday loans, especially from storefront operations and from those licensed lenders who must report to state regulators. While high-cost loan products in a number of states have been modified to fall outside of the definition of a payday loan, this is generally done to evade state laws in an attempt to offer less regulated loans to the general population, rather than to evade the military rate cap specifically. It is likely that—for most payday lenders—the reputational risk of offering loans to members of the military is not worth the small share of overall profits they would provide.

Additional materials from CRL website:

[Military & Payday Overview](http://www.responsiblelending.org/payday-lending/policy-legislation/congress/military-and-payday.html)

<http://www.responsiblelending.org/payday-lending/policy-legislation/congress/military-and-payday.html>

[DOD reports on implementation of the Military Lending Act](http://www.responsiblelending.org/payday-lending/policy-legislation/congress/Senate-Report-Final.pdf)

<http://www.responsiblelending.org/payday-lending/policy-legislation/congress/Senate-Report-Final.pdf>

[Advocates comment on the implementation of the Military Lending Act](http://www.responsiblelending.org/payday-lending/policy-legislation/congress/MIL_DOD_08_MLA_CommentsFinal-2_23.pdf)

http://www.responsiblelending.org/payday-lending/policy-legislation/congress/MIL_DOD_08_MLA_CommentsFinal-2_23.pdf

[Mainstream Banks Making Payday Loans, 2010](http://www.responsiblelending.org/payday-lending/policy-legislation/regulators/Mainstream-banks-making-payday-loans.html)

<http://www.responsiblelending.org/payday-lending/policy-legislation/regulators/Mainstream-banks-making-payday-loans.html>

[U.S. Senators condemn payday lending, 2006](http://www.responsiblelending.org/payday-lending/policy-legislation/congress/US-Senators-say.pdf)

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