

**Policy Brief: Gaps in the Military Lending Act
Leave Many Service Members Vulnerable
to Abusive Lending Practices**

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**Tom Feltner | Director of Financial Services
Laura Udis | Senior Financial Services Advocate
Jean Ann Fox | Senior Advisor, Financial Services**



Consumer Federation of America

Introduction

The Military Lending Act and the rule that implements the Act caps interest rates at 36 percent annual percentage rate on several types of consumer credit made to active duty service members and dependents.¹ The Act provides an inclusive definition of interest, called a Military Annual Percentage Rate and also provides additional protections. These include banning certain forms of security, such as a vehicle title or a post-dated check or electronic access to a bank account, mandatory arbitration, as well as other safeguards. These protections were established to prevent high interest rates, repeat borrowing and unfair practices commonly found in credit products used by active-duty service members and their dependents.

Consumer Federation of America's research has shown that the Military Lending Act has, to a limited extent, reduced the availability of high-cost credit such as payday lending and auto title lending.² However, an analysis of state high-cost lending laws conducted by the Consumer Federation of America in March 2013 found that over half of service members are currently stationed in states where high-cost lending is widely available and are not subject to the interest rate cap or consumer protections provided by the Military Lending Act.

Based on this analysis of state laws that permit lenders to exploit definitional weaknesses and loopholes in the Military Lending Act and the rule that implements it, the Consumer Federation recommends that the Department of Defense examine forms of high-cost credit that are not currently subject to the prohibitions and protections established by the Military Lending Act rule and expand its definition of covered consumer credit to include all forms of high-cost credit commonly available to service members and their dependents.

Types of Credit Addressed by the Military Lending Act and the Current DoD Rule

The Military Lending Act protections, including the 36 percent military annual percentage rate, apply to only certain types of payday and vehicle title loans as defined by a Department of Defense rule adopted in 2007.³ While the Military Lending Act statute only excludes residential mortgages and purchase money loans secured by personal property, the current rule implementing the statute applies only to a short list of credit products. These types of credit are:

1. **Payday loans.** Closed-end credit with a term of 91 days or fewer in which the amount financed does not exceed \$2,000 and the covered borrower:
 - a. Receives funds from and incurs interest and/or is charged a fee by a creditor and provides a post-dated check or other payment instrument to the creditor who agrees with the covered borrower not to deposit or present the check or payment instrument for more than one day, or;

¹ 10 U.S.C. §987(b) & 32 C.F.R. §232.4(b).

² Jean Ann Fox, "The Military Lending Act Five Years Later," Consumer Federation of America, May 29, 2012, <http://www.consumerfed.org/pdfs/Studies.MilitaryLendingAct.5.29.12.pdf>

³ 32 C.F.R. §232.3(b).

- b. Receives funds from and incurs interest and/or is charged a fee by a creditor, and contemporaneously with the receipt of funds, authorizes the creditor to initiate a debit or debits to the covered borrower's deposit account (by electronic fund transfer or remotely created check) after one or more days.
2. **Vehicle title loans.** 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. Credit transactions to finance the purchase or lease of a motor vehicle when the credit is secured by the vehicle being purchased or leased are exempt.
3. **Refund Anticipation Loans.** Closed-end credit expressly paid with the proceeds from a tax refund. Due to the actions of federal regulators, tax refund anticipation loans are no longer widely available from depository financial institutions. To the extent that refund anticipation loans are offered by non-depository financial institutions, the Military Lending Act prohibitions and protections would apply.

Prohibitions and Protections Of the Military Lending Act

Once a product meets the DoD rule definition of covered consumer credit, the Military Lending Act puts in place certain protections for high-cost credit made to active duty service members and their dependents by prohibiting lenders from:

1. Charging more than 36 percent annual interest, which includes most fees (but not late or default fees) and any premiums for credit insurance sold in conjunction with the loan. This inclusive interest rate cap is stated as the Military Annual Percentage Rate (MAPR).
2. Securing a loan with a personal check or other access to the borrower's bank account, title to a personal vehicle, or requiring payment by military allotment.
3. Charging prepayment penalties and engaging in roll-overs, renewals, refinancing or consolidation unless the renewal is at better terms for the borrower, such as a lower cost.
4. Including mandatory arbitration clauses, waiver of legal rights, and onerous legal notices in case of disputes in the loan contract.

Forms of High-Cost Credit Not Addressed by the Military Lending Act under the Current DoD Rule

Under the current Department of Defense rule, the prohibitions against charging interest rates exceeding 36 percent and the additional protections included in the Military Lending Act do not apply to:

- Payday loans with a loan term longer than 91 days; or vehicle title loans with a loan term longer than 181 days;
- Payday, car title, or tax refund loans that are structured as open-end credit, including payday loans made by banks;
- Payday loans for amounts larger than \$2,000; and
- Other general consumer credit transactions such as installment lending, open-end credit, and retail installment credit other than that specifically excluded by the Military Lending Act.

Federal Regulators Define Payday Loans More Broadly Than the Current DoD Rule

Since the passage of the MLA and the adoption of the Department of Defense rule that applies the MLA consumer protections to certain forms of payday, vehicle title loans, and refund anticipation loans, several federal regulators have released materials that employ more expansive definitions than the current Department of Defense rule.

The Consumer Financial Protection Bureau's Examination Procedures for Short-Term, Small-Dollar Lending defines payday lending as both open- or closed-end and notes that these loans may have terms under one month or as long as six months.⁴

The Consumer Financial Protection Bureau's white paper entitled *Payday Loans and Deposit Advance Products* found that variations of the traditional two-week payday loan, including longer-term payday installment and open-end payday loans, are common and often driven by state law.⁵

Both the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency issued proposed guidance in April 2013, finding that open-end deposit advance loans made by depository institutions, or bank payday loans, posed many of the same problems as other payday loans.⁶

⁴ CFPB Examination Procedures for Short-Term, Small Dollar Lending, <http://files.consumerfinance.gov/f/2012/01/Short-Term-Small-Dollar-Lending-Examination-Manual.pdf> at p. 2.

⁵ CFPB, Payday Loans and Deposit Advance Products, A White Paper of Initial Data Findings, April 24, 2013, http://files.consumerfinance.gov/f/201304_cfpb_payday-dap-whitepaper.pdf at p. 8.

⁶ The proposed guidances are available at <http://www.gpo.gov/fdsys/pkg/FR-2013-04-30/pdf/2013-10101.pdf> and <http://www.gpo.gov/fdsys/pkg/FR-2013-04-30/pdf/2013-10094.pdf>.

Eleven States Permit Forms of Payday Lending Not Covered by the Military Lending Act

In at least eleven states, for various reasons, the Department of Defense rule does not apply to all payday lending permitted by state law. Seven state laws that authorize payday lending do not set a maximum loan term in defining the product, so loans longer than 91 days can be made. These states include **Alaska, Idaho, Indiana, Ohio, Rhode Island, South Dakota, and Utah**. In addition, **Colorado** and **Illinois** have minimum loan terms that exceed the 91 days. In **Texas**, under the state's Credit Access Business law, loan terms up to 180 days are permitted.⁷

In addition, the Department of Defense rule that implements the Military Lending Act applies only to closed-end payday loans – excluding open-end or revolving credit. When the Act was passed and the rule implementing the Act was adopted, payday loans were commonly structured as closed-end credit. However, **Virginia** currently permits payday loans to be structured as open-end credit with no rate caps, licensing or supervision requirements. Many payday lenders have modified their loan products to be open-end lines of credit, not covered by the DoD definition of a payday loan, despite the fact that the credit limit is the amount of the payday loan, the initial loan or draw reduces the entire credit limit, and the required repayment amount is the amount of the entire loan.

Another recent development is the industry trend toward larger and longer term installment payday loans that fall outside of the DoD definition of payday loans and the Military Lending Act's protections. A recent survey of 19 online payday lenders found that 12 offered loans in amounts over \$2,000 and 17 offered loans with terms longer than 91-days, although some loans were as short as four months.⁸

In total, 356,894, or 29 percent of active duty service members in 2011 were stationed in the 11 states that permit payday lending not subject to the prohibitions and protections of the Military Lending Act.⁹

⁷ Tex. Fin. Code § 393.201(b)(2).

⁸ Source: Consumer Federation of America's survey of internet websites conducted in April 2013.

⁹ CFA analysis of state high-cost loans conducted in March 2013 applied to demographic data contained in Department of Defense, Office of the Deputy Under Secretary of Defense (Military Community and Family Policy), "2011 Demographics: Profile of the Military Community" Exhibit 2.34 at p. 32, available at http://www.militaryonesource.mil/12038/MOS/Reports/2011_Demographics_Report.pdf.

Thirteen States Permit Forms of Vehicle Title Lending Not Covered by the Military Lending Act

In at least thirteen states, for various reasons, the Department of Defense rule does not apply to all vehicle title lending permitted by state law. There are eight states that do not set a maximum loan term for car title loans or permit a loan term that may exceed 181 days. These states are **Arizona, Illinois, Missouri, Nevada, New Mexico, South Dakota, Utah, and Wisconsin.**

In five states, auto title lenders exploit loopholes in state laws to make loans that can exceed the defined parameters under the Department of Defense rule. Open-end vehicle title loans are permitted in **Kansas** with no rate cap. Vehicle title loans are made in **Louisiana** via a loophole in that state's small loan law and are not limited to 181 days in duration. In **California** vehicle title loans are made for amounts larger than \$2,500 and for terms longer than 181 days since California law does not place any restrictions on loans over \$2,500. Title loans are made in **South Carolina** without any limits as long as the loan exceeds \$600. Title loans are offered in **Ohio** under the state's credit services organization law with no product limits. **Arizona** also permits vehicle title loans to be made to consumers who do not own their vehicles under that state's secondary motor vehicle finance law.

In total, 335,291, or 28 percent of active duty service members in 2011 were stationed in the 13 states that permit vehicle title lending not subject to the prohibitions and protections of the Military Lending Act.¹⁰

¹⁰ CFA analysis of state high-cost loans conducted in March 2013 applied to demographic data contained in Department of Defense, Office of the Deputy Under Secretary of Defense (Military Community and Family Policy), "2011 Demographics: Profile of the Military Community" Exhibit 2.34 at p. 32, available at http://www.militaryonesource.mil/12038/MOS/Reports/2011_Demographics_Report.pdf.

Service Members Stationed in States that Permit High-Cost Nonbank Payday and Title Lending Not Covered by the Military Lending Act¹¹

| State | Payday Lending not Covered by MLA | | Title Lending not Covered by MLA | | Any MLA Loophole | |
|--|-----------------------------------|---------------------|----------------------------------|---------------------|------------------|---------------------|
| | Status | Military Population | Status | Military Population | Status | Military Population |
| Alaska | Yes | 21,624 | - | - | Yes | 21,624 |
| Arizona | - | - | Yes | 21,072 | Yes | 21,072 |
| California | - | - | Yes | 161,864 | Yes | 161,864 |
| Colorado | Yes | 39,004 | - | - | Yes | 39,004 |
| Idaho | Yes | 3,678 | - | - | Yes | 3,678 |
| Illinois | Yes | 18,333 | Yes | 18,333 | Yes | 18,333 |
| Indiana | Yes | 803 | - | - | Yes | 803 |
| Kansas | - | - | Yes | 26,176 | Yes | 26,176 |
| Louisiana | - | - | Yes | 17,266 | Yes | 17,266 |
| Missouri | - | - | Yes | 15,878 | Yes | 15,878 |
| Nevada | - | - | Yes | 11,177 | Yes | 11,177 |
| New Mexico | - | - | Yes | 12,740 | Yes | 12,740 |
| Ohio | Yes | 6,659 | Yes | 6,659 | Yes | 6,659 |
| Rhode Island | Yes | 2,536 | - | - | Yes | 2,536 |
| South Carolina | - | - | Yes | 35,916 | Yes | 35,916 |
| South Dakota | Yes | 3,616 | Yes | 3,616 | Yes | 3,616 |
| Texas | Yes | 131,121 | - | - | Yes | 131,121 |
| Utah | Yes | 4,102 | Yes | 4,102 | Yes | 4,102 |
| Virginia | Yes | 125,418 | - | - | Yes | 125,418 |
| Wisconsin | - | - | Yes | 492 | Yes | 492 |
| Total | 11 | 356,894 | 13 | 335,291 | 20 | 659,475 |
| % Military Population Stationed in a Loophole State | | 29% | | 28% | | 54% |

Source: CFA analysis of state nonbank payday and title loan laws conducted March 2013 applied to Department of Defense demographic data

¹¹ Demographic data contained in Department of Defense, Office of the Deputy Under Secretary of Defense (Military Community and Family Policy), “2011 Demographics: Profile of the Military Community” Exhibit 2.34 at p. 32, available at http://www.militaryonesource.mil/12038/MOS/Reports/2011_Demographics_Report.pdf.

Policy Recommendations

As a result of both the Department of Defense rule's narrow definition of consumer credit and the statutory and structural loopholes described above, as of September 2011, 659,475 active duty service members – 54 percent– and their dependents, out of a total U.S. population of 1,214,925 active duty service members, may not have received all of the Military Lending Act's protections from high-cost payday or vehicle title loans.

This is a conservative estimate because it only addresses nonbank payday and title loans. Service members in other states may also be using high-cost loans not covered by the Military Lending Act's protections, such as bank payday loans, high-cost storefront or online installment loans (consumer finance loans), and other products, such as overdraft protection or rent-to-own transactions.

To address the limited definitions in the current Department of Defense rule implementing the Military Lending Act that leaves more than half of the active duty service member population and their dependents vulnerable to abusive high-cost lending, the Consumer Federation of America recommends that the Department of Defense:

- 1) Eliminate the current product definitions in the Department of Defense rule implementing the Military Lending Act that limit covered consumer credit to a subset of payday loans, vehicle title loans and refund anticipation loans available to service members; and
- 2) Broadly apply the prohibitions and protections included in the Military Lending Act to any form of high-cost credit, regardless of the term of the loan or whether it is structured as open-end or closed-end credit. This should be accomplished by simplifying the Department of Defense definition of covered consumer credit to include any transaction considered consumer credit under the Truth in Lending Act.¹² Protections should also be provided for overdraft protection and rent-to-own transactions.

¹² Subject to the MLA's statutory exclusions for residential mortgages and purchase money loans for automobiles and other personal property. See 10 U.S.C. §987(i)(6).