

The extension of high-cost credit to servicemembers and their families



Consumer Financial
Protection Bureau

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1. Introduction

In 2006, Congress enacted the Military Lending Act (10 U.S.C. 987) as part of the John Warner National Defense Authorization Act for Fiscal Year 2007. The Military Lending Act provides important protections for servicemembers and their families by (1) expressly capping the rate which a creditor may extend consumer credit to covered members of the armed forces or their dependents at no more than 36 percent including fees;¹ and (2) creating a series of special consumer protections for covered members and dependents. The Military Lending Act is implemented by the Department of Defense and, pursuant to a 2013 amendment, is enforceable in the same manner as the Truth in Lending Act by the Federal Deposit Insurance Corporation, member banks of the Federal Reserve System, Office of the Comptroller of the Currency, National Credit Union Administration, Consumer Financial Protection Bureau (Bureau), Federal Trade Commission, and certain other specified agencies.²

The market for financial services used by servicemembers and their families is of keen interest to the Bureau. Our Office of Servicemember Affairs is charged with

- Developing and implementing initiatives to educate and empower servicemembers and their families to make better-informed decisions regarding consumer financial products and services;
- Monitoring complaints from the military about consumer financial products and services, and the responses to those complaints; and

¹ 10 U.S.C. 987(b); see also 32 C.F.R. 232.4.

² 126 Stat. 1786; 10 U.S.C. 986(f)(6).

- Coordinating the efforts of Federal and State agencies, as appropriate, regarding consumer protection measures relating to consumer financial products and services offered to, or used by, servicemembers and their families.³

In addition to our responsibility for enforcing the Military Lending Act, the Bureau is one of several federal agencies with which the Department of Defense is obligated to consult on the implementation of the Military Lending Act.⁴ The Department of Defense recently published a proposal to revise the implementing regulations for the Military Lending Act. In the process of consulting with the Department of Defense regarding the Military Lending Act, the Bureau undertook an analysis of information available to us to better understand the market where servicemembers seek and obtain credit. In this Report, we share these insights from the Bureau's findings related to the marketing and extension of high-cost credit to servicemembers.

As currently implemented, the Military Lending Act protections apply to three forms of credit, when such products are extended to servicemembers on active duty or their dependents: (1) closed-end payday loans with terms of 91 days or fewer and for \$2,000 or less; (2) closed-end auto title loans with terms of 181 days or fewer; and (3) closed-end refund anticipation loans.⁵ Any loan that does not fall into one of these categories is not subject to the Act's protections under the existing regulations implementing the Military Lending Act.

This Report contains two parts. First, to better understand servicemember use of a particular high-cost credit product, we analyze a dataset of accounts from depository institutions that offered Deposit Advance Products (DAP) to certain account holders. This analysis follows on the Bureau's April 2013 white paper on consumer use of Payday Loans and Deposit Advance Products.⁶ Second, to assess and describe the ways that consumer credit products available on the market today fall outside of the scope of the Military Lending Act, as currently implemented, we examine the terms of a number of high-cost loans based upon contracts we have received

³ 12 U.S.C. 5493(e).

⁴ 10 U.S.C. 987(h)(3).

⁵ 32 C.F.R. 232.3(b).

⁶ CFPB, "Payday Loans and Deposit Advance Products, a White Paper of Initial Data Findings" (April 2013), available at http://files.consumerfinance.gov/f/201304_cfpb_payday-dap-whitepaper.pdf.

from servicemembers. This information came to the Bureau from servicemembers who voluntarily provided it as a result of our engagement with the military community and outreach to service providers serving the military and military families. The Office of Servicemember Affairs provides outreach to the military community and addresses their consumer protection concerns. This Report is a snapshot of what we have seen in the market for high-cost credit products that are not subject to the protections of the Military Lending Act, as currently implemented.

2. Empirical analysis: Deposit advance products

In April 2013, the Bureau published a white paper on consumer use of Deposit Advance Products (DAP). Deposit advances are lines of credit offered by some depository institutions as a feature of an existing depository account.⁷ For accounts included within the Bureau's white paper sample, a consumer was generally eligible for a deposit advance if she had a deposit account in good standing which was open for a specified period and had a history of recurring electronic deposits above a minimum size.

The deposit advances we analyzed are substantially similar in structure and purpose to payday loans. However, deposit advances structured as open-end lines of credit fall outside of the protections of the Military Lending Act, as it is currently implemented. Credit limits were generally set as a percentage of the account holder's monthly direct deposits, with some institutions setting the maximum credit limit at the lesser of \$500 or 50 percent of the direct deposits from the preceding statement cycle. The cost of the deposit advances studied was disclosed as a fixed fee per amount borrowed, with a typical fee being \$10 per \$100 borrowed. Lenders generally required that deposit advances be repaid automatically when the next qualifying deposit was made into the consumer's account; in the event that an outstanding balance was not fully repaid by incoming deposits within 35 days, the consumer's account was

⁷ Given recent regulatory guidance from the Office of Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation (FDIC), most banks that offered DAP at the time of our study are no longer offering these exact products. The findings here reflect the market at the time of our study period, which predated the recent guidance. See, OCC, "Guidance on Supervisory Concerns and Expectations Regarding Deposit Advance Products" (November 2013), available at <http://www.occ.gov/news-issuances/news-releases/2013/nr-ia-2013-182a.pdf>; FDIC, "Guidance on Supervisory Concerns and Expectations Regarding Deposit Advance Products" (November 2013), available at <http://www.fdic.gov/news/news/press/2013/pr13105a.pdf>.

debited for the amount due, even if this resulted in the associated deposit account being overdrawn. Because there was no fixed repayment date, the fee could not be used to calculate an annual percentage rate (APR) for the advance at the time that the credit is extended. For a 12-day duration, the median of the sample used in our white paper, and given the fee structure described above, the APR for a typical deposit advance would be 304 percent.

The data used in the Bureau's April 2013 white paper came from a number of depository institutions during a 12-month study period.⁸ About half of the institutions' consumer deposit accounts were eligible for deposit advances.

In order to better understand usage of deposit advance products by servicemembers, we identified some accounts in this dataset belonging to servicemembers.⁹ Within an average month, there were at least 55,000 Servicemember Accounts identified at these institutions.¹⁰ The subset analyzed was randomly drawn from a larger dataset; this figure represents an estimate of the Servicemember Accounts within the full dataset. Of those who were eligible to take a deposit advance at some time during the 12-month study period, 22.15 percent of Servicemember Accounts obtained at least one advance. In the full sample of accounts (including Servicemember Accounts and the general population), 15.79 percent of those who were eligible used deposit advance products (see Figure 1).¹¹

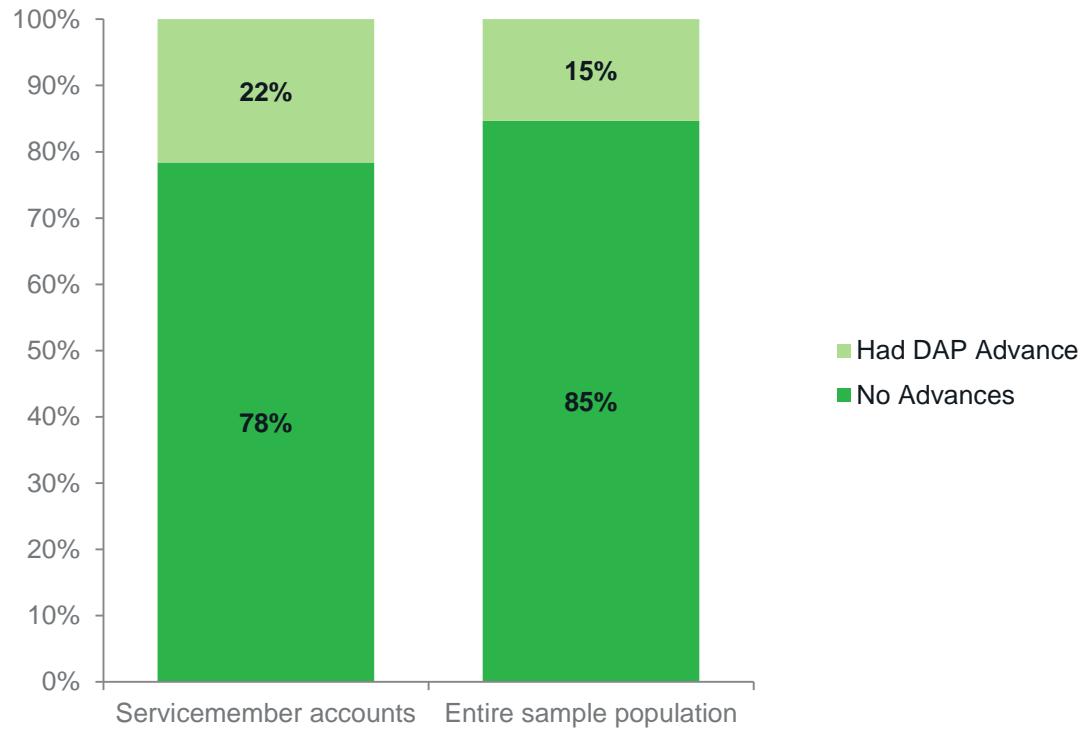
⁸ The April 2013 white paper and this report rely on confidential supervisory data. Consistent with the CFPB's confidentiality regulations, the data findings presented in the white paper and this report do not directly or indirectly identify particular institutions or consumers involved. See 12 C.F.R. 1070.41(c).

⁹ We used information published in the Treasury Department's Green Book Guide to Federal ACH Payments to identify active duty payments from the Army, Air Force, Navy, Marine Corps, or Coast Guard. Staff analyzing these ACH data did not have access to directly identifying personal information about any individual consumer or servicemember. Our subset is likely under-inclusive as compared to all the accounts in the dataset actually held by consumers covered by the Military Lending Act because it likely excludes many accounts held by spouses or other dependents covered by the Act, as well as National Guard and reservists called to active duty.

¹⁰ The numbers in this paragraph are estimates of the total population of account holders at the depository institutions in the dataset. We used the ratio of the sample dataset numbers to the relevant account holder population at institutions in the dataset to derive this estimate.

¹¹ While this difference is statistically significant, some or all of the difference could be explained by differences in the two populations. This finding does not mean that being a servicemember makes a person more likely to use deposit advance products.

FIGURE 1: DAP USAGE IF ELIGIBLE



Analyzing the intensity and volume of deposit advance use by these accounts, we estimate that servicemember borrowers took more than \$50 million in deposit advances at the institutions analyzed during the 12-month study period. For a typical fee of \$10 per \$100, these \$50 million in advances would be associated with \$5 million in fees.

The findings indicate that some depository institutions extended millions of dollars in deposit advances to servicemembers with APRs that typically exceeded 300 percent. However, deposit advances structured as open-end lines of credit are not subject to the Military Lending Act's limitations under the current regulations.

3. Market analysis: Credit contracts

Through our work to understand the credit markets, handle consumer complaints, engage with servicemembers, and investigate potential violations of federal law, the Bureau has identified numerous other examples of high-cost credit products that are not subject to the protections of the Military Lending Act, as currently implemented. We have heard from servicemembers, family readiness officers, judge advocates general, and military aid societies with concerns about the use of high-cost credit within the ranks and the impact of these particular kinds of loans on servicemembers and their families.¹² The following examples provide details on just some of the high-cost loans not subject to the protections of the Military Lending Act that we have seen extended to servicemembers and their families.

A lender licensed under the Illinois Consumer Installment Loan Act extended an auto title loan to the spouse of a servicemember at an APR of 300 percent. For the 12-month contract term, the \$2,575 loan, including a \$95 lien fee, carried a finance charge of \$5,720.24. The loan agreement provided the lender with a security interest in the borrower's vehicle and contained a binding arbitration agreement. Although the Military Lending Act prohibits lenders from taking a non-purchase money security interest in the vehicle of a borrower covered by the law, charging a rate of interest in excess of 36 percent, and requiring covered borrowers to submit to arbitration, the auto title loan in Illinois was not subject to the protections of the Military Lending Act because it had a duration longer than 181 days.

¹² The information discussed herein was provided to the Bureau voluntarily by consumers and financial counselors. It was not gathered through the Bureau's supervisory activities.

An internet-based lender located offshore that targets military borrowers through their marketing extended to a servicemember a line of credit with an APR of 584 percent. In addition to the stated finance charge, the lender charged a “credit access fee” and a “transfer fee” for each draw on the \$1,447 credit line. The contract provided the lender with authorization to debit the borrower’s bank account for the minimum payment due each payment period. This loan made to a borrower in Delaware was not subject to the protections of the Military Lending Act because it was structured as an open-end line of credit.

A lender operating under the Tennessee Industrial Loan Law extended to a servicemember an unsecured installment loan with an APR of 83.02 percent. The \$540.46 loan was repayable over seven months and carried a finance charge of \$159.54. The borrower provided the lender with a security interest in personal property; the contract provided the lender with the right to take possession and sell the property in the event that the borrower failed to make a payment when due. Concurrent with the extension of credit, the borrower also signed an arbitration agreement with the lender. This Tennessee loan was not subject to the protections of the Military Lending Act because the duration of the loan exceeded 91 days and because the lender did not take a post-dated check or other authorization to debit the borrower’s account.

A lender operating pursuant to the California Financial Lenders Law extended to a servicemember an installment loan with an APR of 219.12 percent. The finance charge on the \$2,600 loan (including \$300 credited to an existing account with the lender) was \$3,966.84 over the 12-month term. Concurrent with the extension of the loan, the borrower authorized the lender to initiate an electronic funds transfer for repayment. Although the Military Lending Act prohibits lenders from taking account access to repay a debt and from charging a cost of credit that exceeds 36 percent Military Annual Percentage Rate, this loan was not subject to the protections of the Military Lending Act because the amount financed was more than \$2,000 and the loan duration exceed 91 days.

A lender in Texas extended to a servicemember an installment loan carrying an APR of 584.72 percent. For the \$485 loan, the borrower was required to pay \$1,428.28 over a period of just less than six months. The finance charge included 9.75 percent interest on the loan and a separate Credit Access Business fee. The lender took authorization to debit the borrower’s bank account for repayment of the loan. This loan was not subject to the protections of the Military Lending Act because the duration of the loan exceeded 91 days.

These examples underscore the assessment that there are a number of ways that consumer credit products can be structured to fall outside of the scope of the Military Lending Act, as it is currently implemented. Lenders can avoid the Military Lending Act's limitations when they offer open-end lines of credit, contract for an initial duration of greater than 91 days for payday loans or 181 days for auto title loans, or finance an initial amount of more than \$2,000 for payday loans.

The products that have been marketed and extended to servicemembers while the current Military Lending Act regulations have been in place underscore the limitations of those regulations in protecting servicemembers and their families across the credit marketplace. This issue is of substantial concern to the Bureau and we will continue to use the tools available to us to address the consumer financial challenges affecting the military community.

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