PROTECTING CONSUMERS.
PROMOTING TRANSPARENCY.
EMPOWERING CITIZENS.

December 2, 2014

Honorable Jessica L. (Garfola) Wright
Under Secretary for Defense (Personnel and Readiness)

Department of Defense
4000 Defense Pentagon
Washington, DC 20301-4000

Re: Public Inquiry – Limitations on Terms of Consumer Credit Extended to Service Members and Dependents
Docket No.: [DOD-2013-OS-0133]

PUBLIC COMMENT ON THE PROPOSED RULES TO AMEND THE TERMS OF CONSUMER CREDIT EXTENDED TO SERVICE MEMBERS AND DEPENDENTS

Dear Secretary Wright:

Georgia Watch is the state's trusted and relentless advocate for all Georgia consumers. Our mission is to empower and protect consumers on matters that impact their wallets and quality of life through education, advocacy and policy development. While we serve all Georgia consumers, we are particularly dedicated to ensure that the most vulnerable of our population have representation and access to necessary resources, and are aware of their statutory rights in the consumer marketplace. To this end, we work tirelessly to influence public policies that positively impact consumers, safeguard consumer protections in the areas of personal finance and identity theft, promote access to safe and affordable healthcare, encourage fair utility rates and renewable energy options and protect access to the civil justice system.

As the state's leading consumer advocacy organization, we strongly support efforts of the Department of Defense ("DoD") to address the current weaknesses of the Military Lending Act ("MLA") and we endorse robust efforts that will protect service members and their families from debt traps through regulation, education and development of financial products that consumers use to meet their short-term borrowing needs and financial obligations.

Through our work in the predatory lending arena, it is apparent that service members and their families are vulnerable to and often fall prey to payday lending, title pawn, and other harmful consumer credit products the MLA was specifically designed to govern. As of 2012, there were 72,976 active duty members serving in the state of Georgia, which is the fifth largest population of active duty members of any state in the nation. The ten states with the largest population of service members make up roughly 71% of America's active duty population. In terms of select reserve population – with 27,730 select reserve members – Georgia is ranked sixth in the nation.

Thus between active duty and select reserve, Georgia has 100,706 active duty and reserve service members. Georgia is also home to thousands of military family members and dependents. Of the active duty force: 38.6% are married with children, 17.5% are married with no children, 5.2% are single parents, and 38.7% are single with no children.[1]

As the DoD has noted, military personnel can become financially distressed and suffer involuntary separation due to loss of security clearances, with the 10 year costs of this financial distress ranging from $1.912 billion to $4.348 billion. This range does not account for the additional impact related to troop morale, military readiness and family well-being. The financial stresses can be more significant, especially in Georgia where state law provides very few protections for service members or their dependents beyond the MLA.

The targeting of military personnel by short term lenders is not inadvertent and can be best exemplified by looking at the high volume of lenders that cluster outside of the gates of military bases. An article from the Ohio State Law Review conducted a study comparing the concentration of short term lenders per capita near military bases with their concentration in non-military areas in the same state. The study showed that payday lenders are present in areas near military bases at much higher rates than expected based on the population of the area alone.[2] For example, on the ten mile road from Phenix City, AL and across the state border to Fort Benning, GA there are 15 payday lenders.

Based on the average number of payday lenders per capita found in the rest of the United States, it was expected that only 4-5 lenders would be operating in this area; yet due to the military installation and population nearby, the frequency of quick cash lenders is three times higher than expected.[3]

Although little action has been taken at the state level to address the shortcomings stemming from exploitation of loopholes present in the MLA, the DoD's proposed revisions (79 Fed. Reg. 58602) will fix a majority of the concerns about the regulatory definition of "consumer credit" in addition to making other important changes that enhance protections for Georgia's fighting men and women and their families. Therefore, while the proposed regulations do not address all opportunities to end predatory lending practices against service members, they are a significant step in the right direction.

QUESTIONS #1– INCORPORATION OF TILA DEFINITION OF "CONSUMER CREDIT"

We applaud the effort to broaden the scope of "consumer credit" under the MLA by making that definition consistent with the kinds of credit that have long been subject to the protections under the Truth in Lending Act (TILA). Under this proposal, loans that have traditionally been exempt

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[1] Department of Defense, "2012 Demographics Profile of the Military Community" 2012.

[2] Steven M. Graves and Christopher L. Peterson, "Predatory Lending and the Military: The Law and Geography of 'Payday' Loans in Military Towns", 66 Ohio St. L.J. 653 at 713.

[3] Steven M. Graves and Christopher L. Peterson, "Predatory Lending and the Military: The Law and Geography of 'Payday' Loans in Military Towns", 66 Ohio St. L.J. 653 at 713.

from the protections of the MLA are now covered. In particular, open-ended and close-ended short-term quick cash advance products that include most vehicle title and payday loan variants by whatever name called would be included. By defining "consumer credit" consistently with the transactions regulated under TILA, the regulations will promote uniformity and help close the unintended loopholes that some lenders have been exploiting since the MLA was passed in 2007.

For example, in Georgia, the General Assembly authorizes pawnbrokers to deviate from the state usury limits by permitting them to charge upwards of 300% APR for the first three months, and then 150% APR thereafter. One recent practice we have been following in Georgia that intends to specifically avoid application of the MLA is a creditor's argument that "vehicle pawn transactions" in Georgia fall outside MLA's coverage because the regulations only incorporate "vehicle title loans" into the definition of "consumer credit" because "vehicle pawn transactions" which are not technically considered to be "credit" by operation of state law. Although Regulation Z includes "pawn transactions" as a type of closed-end credit that is governed by TILA, the lender has asserted that since the MLA did not incorporate TILA's definition of "consumer credit", "vehicle pawn transactions" fall outside the scope of MLA's protections. [4] Had the MLA not expressly banned the lender from requiring service members to arbitrate their disputes, the federal court would not have the opportunity to analyze the transactions and conclude that regardless of the name given to them by the lender, they are subject to the MLA.[5]

The proposed definition of consumer credit will cover most of the variants of quick cash advance loans we see that are abusive towards consumers, and these prohibitions and limitations will encourage service members to develop durable relationships with reputable banking institutions and credit unions without falling prey to the subprime and predatory lending debt traps that are so pervasive around military installations in Georgia and across the country.

QUESTION 4 – MLA EXEMPTION FOR INSURED DEPOSITORY INSTITUTIONS AND INSURED CREDIT UNIONS

Georgia Watch believes that under no circumstances should financial products offered by insured depository institutions or national banks be exempted or excused from the requirements and limitations of the MLA. History shows that across this Nation, one of the most effective ways of enabling payday lenders to avoid state law usury prohibitions is through the use and development of what consumer advocates commonly refer to as "Rent-a-Bank" schemes. Under this scenario, payday lenders posed as the "servicing agent" for a bank chartered in a different state where there are no limitations on the amount of interest can be charged on small loans. Under the National Banking Act and Federal Deposit Insurance Act, these out-of-state banks are permitted to "export" the exorbitant interest rates of their home state (e.g., South Dakota) that in-state

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[4] *See, e.g., Cox v. Community Loans of America, Inc.*, Case No. 4:11-cv-00177-CDL, (MD Ga. 2011) Dkt. #204, Order dated 3/24/14 (district court rejecting lender's argument that vehicle pawn transactions are not covered by the MLA), appeal pending Case No. 14-12977 (11th Cir. 2014).

[5] *Id.* (rejecting similar arguments that state laws in Alabama, Mississippi, Tennessee and Texas removes certain transactions from MLA's reach by allowing third-party affiliations that mask the identity of *Affiliates* who serve as "creditors" and limit the amount of "interest" being charged.

payday lenders would then use to make loans in the name of the out-of state bank. The payday lender paid the bank a monthly fee for the ability to use the bank's charter – hence the term "Rent-a-Bank." The out-of state bank had very little involvement in the loans other than lending its name to the transaction and receiving a small portion of the loan proceeds that were repaid. In practice, the in-state payday lender advanced 100% of the loan proceeds, bore all of the expense and risk associated with the loans and kept most of the illegal interest that was charged for the loan.[6] The Georgia General Assembly recognizes such arrangements are "a scheme or contrivance by which the agent seeks to circumvent…the usury laws of this state," OCGA § 16-17-1(c), and classifies them as "racketeering activity." OCGA § 16-14-3(()(A(xxxviii).[7] If these out-of-state banks (insured depository institutions and credit unions) are exempted from the MLA, abusive lending schemes will surely find a way to exploit this unintended loophole.

It is also important to note that most of the sub-prime, short-term lenders, car title and title pawn entities, rent-a-center businesses and other "easy credit" service providers require that consumers sign a mandatory arbitration clause as a condition to receiving any service or product offering. By signing these documents, consumers are waiving their right to seek meaningful relief and legal redress in a court of law. Unfortunately, most consumers either do not realize what these mandatory arbitration clauses entail, or they do not read them carefully. When a service member has a legitimate legal claim against one of these lenders, the mandatory arbitration clause prevents viable legal tools, like the MLA, from being used to challenge unlawful and abusive lending practices.

In summary, if the final regulations for the amended MLA carve out exemptions to insured depository institutions or insured credit unions, the Department can rest assured that predatory lenders will return to exploit these loopholes by partnering with exempted insured depository institutions and insured credit unions, or directly offering financial products themselves. Although wholly inconsistent with the terms and limitations of the MLA, these so-called ancillary products and services that may be offered in the name of insured banks and credit unions would not be governed by the MLA. Further the Department can rest assured that if such financial products or services are not subject to the protections of the MLA, service members and their families will indeed be compelled to arbitrate disputes over such products, which is also inconsistent with the MLA's express ban on forcing service members into arbitration. The result will be a hodge-podge of confusing legislation that significantly loses its strength and its protections.[8]

There is no legitimate basis for exempting an insured depository institution or credit union from application of the MLA, while requiring compliance from their competitors. Whether offered

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[6] *See Georgia Cash Am., Inc. v. Greene*, 318 Ga. App. 355, 356, 734 S.E.2d 67, 69 (2012), *cert. denied.*

[7] For a comprehensive report by the Consumer Federation of America on business models payday lenders use to avoid state usury prohibitions, see CFA Report, *Unsafe and Unsound: Payday lenders Hide Behind FDIC Bank Charters to Peddle Usury* (March 30, 2004).

[8] For comments concerning the dangers of forced arbitration, see Docket No. CFPB-2012-0017, Bureau of Consumer Financial Protection's *Request for Information Regarding Scope, Methods, and Data Sources for Conducting Study of Pre-Dispute Arbitration Agreements*, available at http://www.regulations.gov/#!searchResults;rpp=25;po=0;s=CFPB-2012-0017;fp=true;ns=true

through a partnership with a third party vendor or through the likes of a "servicing agent", or by themselves, there should be no carve-outs for insured depository institutions or insured credit unions. Simply stated, if an entity chooses to offer a product that qualifies as "consumer credit" under the MLA regulatory definition, it should be held fully accountable for ensuring compliance with the terms and limitations imposed by the MLA.

QUESTIONS 7, 8 & 9 – MLA EXCEPTIONS FOR OPEN-ENDED CREDIT CARD ACCOUNTS

We certainly agree that access to credit is important for service members and we concur that although some of the fees associated with credit cards are quite high, credit card products, in general, can be beneficial to service members who make meaningful and smart decisions regarding their use. However, we disagree that the regulations should exempt open-ended credit card accounts from the definition of "consumer credit" and the Military Annual Percentage Rate (MAPR) disclosures. The suggested $100 cap on annual participation fees makes some intuitive sense to limit some excessive charges. However, exclusion of predatory credit card cash advance transactions (i.e., open-ended credit extended without considering a service member's ability to repay the advances) may escape important MLA protections and facilitate exploitation of unintended loopholes. This is especially true since the DoD recognizes that some lenders and financial service providers have historically demonstrated the ability to morph their practices to avoid certain prohibitions and requirements. We therefore believe the better rule would be to require ***any and all fees*** associated with ***any and all*** credit card cash advance transactions to fully comply with the terms and limitations of the MLA, including the interest rate caps and ban on forced arbitration. To this end, the new regulations should be carefully considered and then crafted to prevent creditors from being able to transform ancillary credit card services and products into high-cost open-ended credit products that are beyond the scope and reach of the MLA.

Broad inclusion of all credit card cash advance products in the definition of "consumer credit" will prohibit the historical abuses we've seen in most, if not all, "short-term", "easy credit", "quick cash" products. Furthermore, inclusion of all such products would eliminate the need to classify and segregate these various point of sale transactions and develop complicated safe harbor provisions to determine whether bona fide fees are "reasonable and customary" throughout various industry practices.

QUESTIONS 11, 12 & 13 – VERIFICATION OF COVERED BORROWER STATUS

Georgia Watch strongly supports necessary adjustments to the MLA Database with a mandatory requirement that creditors electronically verify a service member or dependent's covered borrower status at the time any covered transactions are consummated. In today's computer age, electronic verification through a Defense Enrollment Eligibility Reporting System (DEERS)-run website affords a simple, convenient, prompt and economical means of closing a major loophole under the existing regulations that allows creditors to require or permit covered borrowers to effectively or unknowingly waive MLA protections. Use of such a mandatory electronic verification system will encourage and promote service member involvement and reduce the

opportunity for fraud and inaccurate covered borrower status determinations. Where this electronic verification process is done, creditors absolutely should be afforded a safe harbor from liability for non-compliant transactions, unless or until the borrower takes responsibility to come forward with actual notice of being a covered borrower. In the face of any conflicting information at the time the transaction is consummated, the creditor should have the choice of treating the borrower as a covered borrower and complying with the MLA, or declining to consummate the transaction until the correct status can be determined. Because of the potential for abuse, and to ensure that covered borrower status is tracked as completely as possible, Georgia Watch urges the Department to require separate verifications of covered borrower status for each transaction, particularly where an existing debt is rolled over, renewed or re-financed.

Finally, while the use of a Covered Borrower Identification Statement (CBIS) is an important tool in making appropriate disclosures to service members and their families, it has not been effective in Georgia to prevent non-compliant transactions from being consummated,[9] and should be available for creditors to use as a means of applying the safe harbor provision.

QUESTION 21 – MANDATORY DISCLOSURES

Georgia Watch is clearly in favor of mandatory and meaningful disclosures that help consumers make better informed decisions about the financial transactions they enter. Importantly, the new regulations should mandate all lenders to proactively disclose the material terms associated with the loan agreement (as TILA requires) in addition to providing information about alternative loan options that have lower costs. We hope that the alternatives provided will include financial counseling, such as those provided by installation-based Army Community Services or other community-based programs like Consumer Credit Counseling and other appropriate programs that are offered by civilian non-profit entities. In addition, we would like to see more proactive disclosure of the programs available to them from the military aid societies. For example, in times of need, service members are eligible to seek loans of varied amounts for terms up to 36 months with 0% APR through Army Community Services and other military relief societies that exist to assist military members and their families when facing financial challenges.

However, although the Department of Defense and military agencies have been proactive in providing financial assistance and guidance, there is evidence to suggest that military personnel are unlikely to seek help due to deeply entrenched cultural mores. For example, a Defense Manpower Data Center (DMDC) survey of enlisted service members asked why soldiers use high cost, short-term loans, instead of cheaper alternative financial products offered by the military. The majority of respondents indicated that they would feel embarrassed by receiving a loan from the military relief societies, and half felt that their commanders would find out and might disapprove.[10] The effort to increase proactive disclosure will need to be supplemented by comprehensive education and stigma reducing efforts throughout the ranks.

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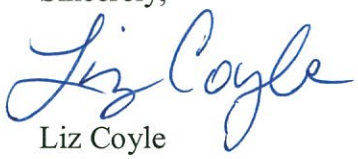
[9] *See Cox v. Community Loans of America, Inc.*, Case No. 4:11-cv-00177-CDL, (MD Ga. 2011) (recognizing some of the problems associated with use of a CBIS as sole means of identifying covered borrowers and providing creditor with safe harbor status).

[10] *Report: Enhancement of Protections on Consumer Credit for Members of the Armed Forces and Their Dependents*, DEPARTMENT OF DEFENSE, at 12 (April 2014).

We appreciate the seriousness with which the Department of Defense is taking the financial concerns of our nation's active duty and dependent populations. Georgia Watch applauds the Department of Defense for issuing strong proposed rules to protect service members and their families from predatory lending practices. We urge you to stand tall in supporting the underlying and fundamental purpose of the MLA, which is to protect the men and women who are called upon to fight for our protection and the freedoms we enjoy.

Sincerely,



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