December 22, 2014

U.S. Department of Defense
1000 Defense Pentagon
Washington, D.C. 20301-3010

Re: Department of Defense Rules Implementing the Military Lending Act (Docket ID: DoD-2013-OS-0133)

Dear Department of Defense:

This letter is submitted by the undersigned attorneys general in response to the first draft of proposed amendments to regulations implementing the Military Lending Act, "Limitations on Terms of Consumer Credit Extended to Service Members and Dependents."

First and foremost, we applaud the Department of Defense ("DoD") for taking affirmative steps to tighten the regulations with regard to cash loans to servicemembers. By eliminating many caveats and loopholes, the proposed amendments will make it much more difficult for payday lenders and other high-priced consumer cash loan companies to prey on servicemembers. Without a doubt, the well-being and strength of our military is compromised when the servicemembers are drawn into a spiral of high-priced debt.

As background, in 2007, the Department adopted rules implementing certain statutorily required consumer protections under the Military Lending Act (MLA) such as a 36 percent cap on interest and fees and other protections. These protections were applied, by DoD rule, to the following three narrow categories:

- Payday loans, but limited to closed-end loans of up to $2,000 for a term of 91 days or less;
- Vehicle title loans are covered, but limited to the closed-end loans secured by the vehicle's title, for a terms of 181 days or less (loans to purchase a vehicle are excluded); and
- Tax refund anticipation loans.

While these rules protected servicemembers from many of the abusive lending practices in the market at the time, many lenders changed their practices to avoid complying with the Military Lending Act entirely. For example, some started offering longer-term payday installment loans with terms slightly *exceeding* 91-days. Other lenders started to offer *open-end*

credit with high rates and the same abusive features as the closed-end payday or title loans covered by the Military Lending Act. Overdraft loans, retail sales credit or other similar rent-to-own transactions where the security by personal property bears no relationship to the amount of the credit advanced are also not covered by the current Military Lending Act rules.

Clearly, reform of the regulations was necessary, and the newly proposed regulations make strides in closing loopholes and accomplishing the intent of the Military Lending Act. The recent proposed rules apply the Military Lending Act protections to largely the same types of credit currently subject to the protections offered by the Truth in Lending Act. This broader approach will improve the odds that servicemembers receive important protections regardless of the structure or duration of the cash loans and will prevent further efforts to purposefully structure loans to avoid the protections offered by the Military Lending Act.

Yet while closing the loopholes on cash loans is laudable, the proposed regulations could do more to protect servicemembers on at least two fronts: 1. The 36% military APR established by statute; and 2. Deceptively structured consumer loans "secured" in name only.

It is important to recall that the Military Lending Act ("MLA") was intended to curb predatory lending practices and protect servicemembers. That has only happened in part. The United States Senate Committee on Commerce, Science and Transportation held a hearing on November 20, 2013, titled "Soldiers as Consumers: Predatory and Unfair Business Practices Harming the Military Community." A full transcript of the hearing may be read at http://www.gpo.gov/fdsys/pkg/CHRG-113shrg89464/pdf/CHRG-113shrg89464.pdf (the "Senate Hearing"). Notably, the hearing highlighted the Military Lending Act as implemented, as well as the areas in which it could be improved: personal property credit agreements and motor vehicle loans. A great deal of the hearing focused on how predatory businesses were bypassing the intended protection of the MLA. Senator Rockefeller's opening statements specifically referenced predatory consumer loans for financing personal property as an area meant to be assisted by the MLA. In the words of Senator Bill Nelson, one of the sponsors of the 2006 MLA, "Why in the world would the Department of Defense constrict the definition of consumer credit from the very broad consumer protection bill that we, with the Joint Chiefs of Staff urging us, passed in 2006?"

Military Annual Percentage Rate (MAPR)

One of the cornerstones of the MLA is the 36% interest rate cap. While this exceeds the usury interest rate caps of many states, including New York, it does protect servicemembers in areas where existing law provides a high cap or no cap at all. The average fixed rate credit card APR nationally has held steady at approximately 13.02% since approximately 2013. Variable rate credit cards are at an APR of approximately 15.68%. Clearly, the MAPR cap set by the MLA allows lenders to charge significant market rates of interest while imposing an upper limit that is necessary in light of current trends.[1]

---

[1] This trend toward more expensive credit and higher profit taking was noted recently by the New York Times Editorial Board: http://mobile.nytimes.com/2014/10/19/opinion/sunday/a-rate-cap-for-all-consumer-loans.html?_r=1&referrer= Interestingly, in its editorial opinion the New York Times highlighted a recent military loan for a vehicle with an effective interest rate of 400%. Unfortunately, under the current MLA, that loan would

The current implementing regulations recognize the 36% MAPR and state that it includes cost elements associated with the extension of consumer credit if they are "financed, deducted from the proceeds of the consumer credit, or otherwise required to be paid as a condition of the credit." 32 CFR 232.3(h)(1). These costs explicitly include interest, fees, credit service charges, credit renewal charges, credit insurance premiums, and fees for credit-related ancillary products. Under the current regulations, MAPR does not include unanticipated charges or fees for actual unanticipated late payments, default, delinquency or similar occurrence, and a variety of taxes or fees prescribed by law.

The proposed regulations do not yield the same clarity on this point. As proposed, lenders may not impose an MAPR "greater than 36 percent in connection with an extension of consumer credit that is closed-end credit or in any billing cycle for open-end credit." Proposed § 232.4(b). Charges included in the MAPR calculation are credit insurance premiums and fees for credit-related ancillary products. The proposal, however, **exempts** from the MAPR calculation any "bona fide fee" including finance charges, application fees, or any fee imposed for participation in any plan or arrangement for consumer credit "to the extent that the charge by the creditor is a bona fide fee, and must be reasonable and customary for that type of fee." This is followed by eight paragraphs describing how a "bona fide" fee is to be evaluated for "reasonable and customary" status. A creditor can attain "safe harbor" by charging fees "less than or equal to an average amount of a fee for the same or a substantially similar product or service charged by 5 or more creditors each with at least $3 billion in outstanding loans on U.S. credit card accounts at any time during the 3-year period preceding the time such average is computed." Proposed § 232.4(d). We fear this proposed amendment will open a wide door through which abusive fees of creative lenders may pass.[2] In light of the statutory definition of interest provided by the MLA, which includes "all cost elements associated with the extension of credit" of every kind, "including fees" (without qualification), we would urge the DoD to adopt a more inclusive calculation of MAPR.

The undersigned attorneys general respectfully request that the proposed regulations utilize the existing calculation of MAPR. Otherwise, we anticipate the new regulations will initiate a "race to the bottom" on fees and charges for credit offers targeted at servicemembers, render the 36% interest rate cap meaningless for all practical purposes, and make it impossible for servicemembers and difficult for regulators to easily evaluate whether or not a credit issuer is violating the MLA in this regard. Certainly the intent of the proposed rulemaking was to tighten loopholes and provide servicemembers the protection promised by Congress.

---

still escape MLA protections because it is credit extended to finance the purchase or lease of a motor vehicle, "secured" by the property being purchased. Abusive lending to servicemembers regularly occurs in obtaining purchase money for new and used automobiles. As extensively detailed at the Senate Hearing, servicemembers are routinely targeted by the auto sales industry and looped into a crippling whirlpool of high interest rates, debt and repossessions. Because the MLA exempts auto dealers from even the most basic protections offered by the MLA: rate caps and payment options, this underscores the importance of providing real protection to the remaining sectors covered by the statute..

[2] For example, instead of offering a predatory installment sales contract, a vendor would likely morph to offering predatory store credit cards at the point of sale, either independently or through a relationship with a lending entity, thereby bypassing the protections of the MLA.

Financing Cars, Electronics and other Consumer Goods

The second major concern with the proposed regulations concerns the failure to address predatory consumer credit agreements crafted to bypass the protections of the MLA, such as loans that are nominally "secured" by purchased property. The MLA exempts such loans from the scope of protected consumer credit. However, it has become clear that unscrupulous lenders are willing and able to use this exemption regularly and disingenuously to cover transactions that exemplify the abusive practices Congress sought to ban. The proposed regulations should be clarified that the exception only applies where there is a valid and enforceable security interest (bearing a reasonable relationship in terms of value) at the time of purchase and throughout the life of the loan and that subterfuge/sham secured transactions that are structured to evade the MLA are not exempt.

As one recent example, in the matter of SmartBuy/Rome Finance, vendors were able to lure servicemembers to purchase household electronics and other items at 300% markups through predatory financing that included effective rates of interest far above the MAPR. The financing arrangements were almost exclusively backed by allotment payments and checking account access—practices that are explicitly banned by the MLA. But, because the Rome Finance agreements were nominally "secured"[3] they arguably would not have been covered by the existing MLA regulations nor would they be by the Department's proposed amendments.[4] In another case, according to recent reporting by the *Washington Post*,[5] a retailer known as USA Discounters has been engaging in substantially the same practices: targeting and trapping servicemembers in debt that exceeds items purchased by substantial multiples, backed by allotments and account accesses that are illegal under the MLA.

We applaud the changes in the allotment procedures that now prohibit allotment for secured transactions. In cases such as these, servicemembers essentially become investment vehicles for private equity investors, who are solicited to deal in "military paper." The investment is profitable and relatively secure since payments are taken directly from a paycheck with no risk of payment reversal. (And if the allotment is stopped, lenders are able to extract funds from a backup bank account.) Servicemembers are particularly vulnerable to these

---

[3] Rome Finance obtained its security interest by including one line buried in the fine print of its credit agreements, wherein servicemembers purportedly would "grant ROME a security interest in all goods transferred by the [Purchase] Agreement."

[4] Due to the violation of a number of state and federal consumer protection laws, earlier this year a number of States and the Consumer Financial Protection Bureau succeeded in forging a settlement that dismantled the Rome Finance entities and achieved over $90-million dollars of relief for thousands of affected servicemembers. *See, e.g.*, Press Release, CFPB and 13 State Attorneys General Obtain About $92 Million in Debt Relief for Servicemembers Harmed by Predatory Lending Scheme (July 29, 2014), available at http://www.consumerfinance.gov/newsroom/cfpb-and-13-state-attorneys-general-obtain-about-92-million-in-debt-relief-for-servicemembers-harmed-by-predatory-lending-scheme/. While this result was fortunate, the clear availability of MLA protections would have provided a more powerful tool that should be available in future cases of this type.

[5] *See* Paul Kiel, *USA Discounters hooks some consumers with credit before springing the debt trap*, WASH. POST, July 25, 2014, *available at* http://www.washingtonpost.com/local/crime/usa-discounters-hooks-some-service-members-with-credit-before-springing-the-debt-trap/2014/07/25/4def7fcc-0dc4-11e4-b8e5-d0de80767fc2_story.html.

practices because, if they do not pay, they may risk their security clearance, and possibly their careers. Servicemembers pay because they are largely unprotected otherwise.

By raising the fig leaf of "security" in the items purchased, abusive lenders are given reason to argue that the Department's regulations do not apply. While MLA itself includes an exemption for secured purchase money loans, Congress could not have intended that all of the things made illegal by the MLA in the field of military lending—such as usurious rates of interest, allotment-based payments, and checking account access—would be allowed every time a lender remembered to include "security" in its fine print. This must be especially true in circumstances where the putative collateral bears no reasonable relation to the amount financed and lenders likely never intend to enforce the security interest. Indeed, these lenders' recourse for a $3000 loan is not the $650 TV securing it, but the allotments and checking account sweeps that are otherwise made illegal by the MLA, to say nothing of the leverage afforded by servicemembers' security clearances and other professional vulnerabilities.

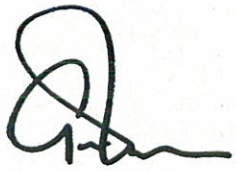
There is still time for the Department to modify the definitions of consumer credit to close these remaining substantial loopholes and provide the coverage envisioned by Congress for our servicemembers. Loans that are made with indicia of fraud and with the characteristics mentioned herein cannot be the "secured" loans Congress intended to allow, and we urge the Department to consider and propose regulations that will make this clear. Without a doubt, the rules should apply uniformly to the full range of consumer credit loans that present real danger to our servicemembers. These changes are critical to protect military borrowers from lenders that purposefully structure transactions to avoid the strictures of the MLA, as well as those that are exempt as an industry.

The undersigned continue to actively work to combat predatory practices targeting servicemembers in our respective states. We urge the Department to take this opportunity to protect servicemembers, and to engage in an open collaboration with the states attorneys general to create more robust MLA protections. The shared goal is to protect our servicemembers on the home front while they so bravely serve the needs of our nation.

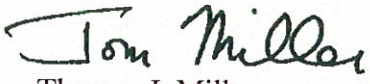
Respectfully submitted,

Dustin McDaniel
Arkansas Attorney General

Kamala D. Harris
California Attorney General

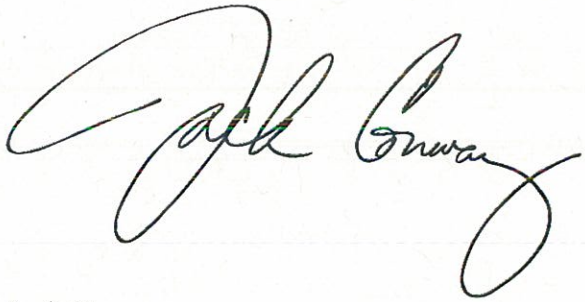


George Jepsen
Connecticut Attorney General



Thomas J. Miller
Iowa Attorney General

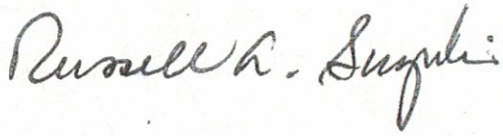
Joseph R. "Beau" Biden, III
Delaware Attorney General



Jack Conway
Kentucky Attorney General

Pam Bondi
Florida Attorney General

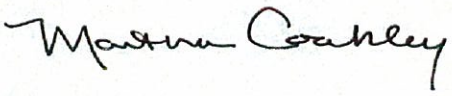
Janet T. Mills
Maine Attorney General



Russell A. Suzuki
Hawaii Attorney General

Douglas Gansler
Maryland Attorney General

Lisa Madigan
Illinois Attorney General



Martha Coakley
Massachusetts Attorney General

Gregory F. Zoeller
Indiana Attorney General

Lori Swanson
Minnesota Attorney General

Gary King
New Mexico Attorney General

Eric T. Schneiderman
New York State Attorney General

Roy Cooper
North Carolina Attorney General

Kathleen Kane
Pennsylvania Attorney General

Peter F. Kilmartin
Rhode Island Attorney General

Herbert H. Slatery III
Tennessee Attorney General

William Sorrell
Vermont Attorney General

Bob Ferguson
Washington State Attorney General