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STUDENT ARTICLE

Protecting Our Protectors: The Defense Department's New Rules to Prevent Predatory Lending to Military Personnel

By Dawn Goulet*

I. Introduction

Navy Air Traffic Controller Matthew Hubbell is like many Americans. His income, although steady, is sometimes not enough to guard against the unexpected. When his wife began a battle with breast cancer, he needed a loan to make ends meet.¹ He thought a short-term payday loan, the kind promoted through advertisements like “\$500 instant cash – no credit check,” or “[m]ake your next payday today,” was the answer.² However, the payday lender required the \$500 he borrowed be paid in full just two weeks later.³ The same financial troubles that prompted him to take out the loan prevented Hubbell from paying it off on time, so he rolled the loan over for another two week period, and another.⁴ Eventually he found

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¹ Chris Cuomo, Mary Harris & Lara Setrakian, *Are Predatory Lenders Ripping Off Our Nation's Finest?*, ABC WORLD NEWS, Aug. 22, 2006, available at <http://abcnews.go.com/WNT/story?id=2343457&page=1> (last visited Oct. 17, 2007).

² *Id.*

³ *Id.*

⁴ *Id.*

himself paying a 390% annual interest rate, trapped in a spiral of high-interest debt.⁵

Mr. Hubbel is not alone. Within 30 miles of his naval base are over 117 short-term lenders catering to military personnel.⁶ Active-duty military personnel are three times more likely than their civilian counterparts to take out payday loans⁷, and one in five service members are payday borrowers.⁸ The Department of Defense (“DOD”) has identified payday lending as one of its 10 key “quality of life” concerns for military families⁹, stating that “[p]redatory lending undermines military readiness, harms the morale of troops and their families, and adds to the cost of fielding an all volunteer fighting force.”¹⁰

The discussion below will examine predatory lending practices, the ways in which predatory lenders target military personnel, why military personnel make such easy targets, and why past efforts to protect them have failed. Finally, the article will examine the rationale behind recent federal legislation enacted to protect service members, and will consider whether the DOD’s new rules for implementing this legislation do all that they should to protect this country’s protectors.

⁵ *Id.*

⁶ Cuomo, Harris & Setrakian, *supra* note 1.

⁷ Ozlem Tanik, *Payday Lenders Target the Military*, CRL ISSUE PAPER NO. 11 (Ctr. for Responsible Lending, Durham, NC), Sep. 29, 2005, at 1, available at <http://www.responsiblelending.org/pdfs/ip011-PaydayMilitary-0905.pdf> (last visited Oct. 17, 2007).

⁸ U.S. Dep’t of Def., REPORT ON PREDATORY LENDING PRACTICES DIRECTED AT MEMBERS OF THE ARMED FORCES AND THEIR DEPENDENTS, at 12, Aug. 9, 2006, available at http://www.defenselink.mil/pubs/pdfs/Report_to_Congress_final.pdf#search+%22%20Department%20of%20Defense%20Report%20on%20Predatory%20Lending%20Practices%20%22 (last visited Oct. 17, 2007) [hereinafter REPORT ON PREDATORY LENDING].

⁹ Peter Geier, *Cash Now, Suits Later: ‘Payday Lending,’ A Military Concern, Stirs Up Litigation*, 28 NAT’L L.J. 1, 1 (2006).

¹⁰ REPORT ON PREDATORY LENDING, *supra* note 8, at 53.

II. Predatory Lending and Its Effects on Military Personnel

A. Predatory Lending Practices

The term “predatory lending” describes a wide variety of unfair or abusive loan or credit transactions and collection methods.¹¹ Such practices include charging high interest rates and high fees, repeated renewals or “loan flipping” that creates a profit for the lender without ever significantly reducing principal, packing loans with high cost ancillary products, fraud or deception, waivers of rights to legal redress, and operations outside state usury laws.¹² Predatory lending is a process that begins with misleading sales tactics directed at borrowers who may not fully understand all the provisions of the contracts they are signing. It ends with borrowers unable to repay the loans they have taken due to excessive fees and interest.¹³

Payday loans—one prevalent form of predatory lending—are transactions in which the borrower obtains a minimal cash advance, typically between \$100 and \$500, on his salary for two weeks.¹⁴ The borrower writes a post-dated check for the amount of the loan, plus a fee of between \$15 and \$35, representing an annual interest rate of 300-400%.¹⁵ Because partial payments are not allowed, often the borrower cannot repay the entire loan amount at the end of the two weeks, and must pay a fee to extend or rollover the loan to prevent the lender from cashing the check and triggering overdraft fees or bounced check penalties.¹⁶ A borrower can become trapped in a cycle of rollover after rollover, in which high renewal fees are paid while little, if any, of the principal balance is reduced.¹⁷ Rollover extensions of existing loans, called “loan flipping,” are what makes

¹¹ *Id.* at 2.

¹² *Id.* at 2-3.

¹³ Aaron Huckstep, *Payday Lending: Do Outrageous Prices Necessarily Mean Outrageous Profits?*, 12 *FORDHAM J. CORP. & FIN. L.* 203, 208 (2007).

¹⁴ Regina Austin, *Of Predatory Lending and the Democratization of Credit: Preserving the Social Safety Net of Informality in Small-Loan Transactions*, 53 *AM. U.L. REV.* 1217, 1222 (2004).

¹⁵ *Id.*

¹⁶ *Id.*

¹⁷ *Id.*

payday lending profitable.¹⁸ Ninety percent of the industry's revenue growth stems from more frequent and larger loans to existing customers.¹⁹

In addition to payday loans, predatory lenders offer consumers car title loans (in which a loan for a fraction of the value of the borrower's vehicle is secured by title to the vehicle, and can result in repossession upon failure to pay),²⁰ tax refund anticipation loans (expensive short-term loans secured by a taxpayer's expected tax refund that are often granted to the lowest earners, those receiving the Earned Income Tax Credit),²¹ and rent-to-own operations (in which the lender typically charges several times the value of an item in rental fees without disclosing the true cost of the eventual purchase).²²

B. Military Targeting

Military personnel make easy targets for predatory lenders offering any of these services. Almost 73% of active-duty military personnel make salaries between \$20,000 and \$30,000 a year.²³ Military personnel are attractive customers for predatory lenders because a great number of them are financially unsophisticated, young, and away from home for the first time.²⁴ They are largely married couples with young children, and many are under intense pressure to pay bills and meet everyday living expenses.²⁵ Unlike many other consumers, however, service members can count on government paychecks to be issued like clockwork, are not in any danger of being laid off from their jobs, and are easy to track for collection purposes through their commanding officers.²⁶ In addition, they are required to maintain financial stability as part of the

¹⁸ REPORT ON PREDATORY LENDING, *supra* note 8, at 14.

¹⁹ *Id.*

²⁰ *Id.* at 16.

²¹ *Id.* at 20.

²² *Id.* at 19.

²³ Stuart Rossman & Hellen Papavizas, *When the Military Paycheck is Prey*, 42-SEP TRIAL 43, 43 (2006).

²⁴ *Id.* at 47.

²⁵ *Id.*

²⁶ *Id.*

military's enforced good-conduct codes.²⁷ In short, they are a predatory lender's dream.

Targeting military families for predatory loans is particularly heinous because it preys on financial vulnerabilities stemming directly from a service member's commitment to defend his country.²⁸ Military personnel often face unexpected expenditures leading up to deployment, and often must leave financial matters in the hands of spouses not accustomed to managing them.²⁹

Payday lenders target military personnel by setting up shop around bases, and by employing "affinity marketing" tactics designed to mislead service members into believing their loans are sanctioned by the United States government. Payday lenders are located in areas near military bases in significantly higher densities than in other areas of the country.³⁰ For example, 31 of the 33 payday lenders in a 1,000-square mile radius of the Fort Bragg and Pope Air Force Bases in North Carolina are located within five miles of the bases.³¹ These lenders place ads for easy loans and fast cash in publications like *Army Times*, *Navy Times*, *Air Force Times*, and *Marine Corps Times*, independently published newspapers that many service members believe are official military publications.³² Such "affinity marketing" tactics lend a misleading air of credibility to the claims made, as if they have been vetted by the military to screen out any undesirable lenders.³³ Online searches for terms like "military payday loans"

²⁷ *Id.* Although financial problems rarely trigger military discipline, payday lenders use these unlikely measures as threats when lending to service members. One payday loan "Repayment Agreement" states: "If I fail to provide these funds, I understand that this will be a violation of Articles 123a and 134 of the UCMJ [Uniform Code of Military Justice], punishable by up to six months' confinement, forfeiture of all pay and allowances, and a bad-conduct discharge ... I authorize the [creditor] to contact my military supervisors in these matters." Rossman & Papavizas, *supra* note 23, at 47.

²⁸ *Id.* at 43.

²⁹ *Id.* at 49.

³⁰ Tanik, *supra* note 7, at 3.

³¹ *Id.* at 2-3 (relying upon a 2005 study by Christopher Peterson, assistant professor, Levin College of Law, University of Florida, and Steven Graves, assistant professor, California State University-Northridge. The study analyzed 20 states and almost 15,000 payday shops. Payday lenders were found in greater concentrations near military bases in 19 of the 20 states studied).

³² Rossman & Papavizas, *supra* note 23, at 48.

³³ *Id.*

result in numerous paid, sponsored links to sites purporting to offer special loans for military personnel, utilizing official-looking military seals, and promising, "If you're serving . . . you're pre-approved!"³⁴ Retired military personnel are even sometimes recruited to pitch loans and other services to service members, giving the impression that the military has actually endorsed their products.³⁵

C. Failure of Prior Efforts to Protect Military Personnel

Traditionally the payday lending industry has been regulated primarily by state law.³⁶ Some states have developed regulatory efforts limiting predatory lending practices and capping interest rates, while others have declined to do so.³⁷ Although the Armed Forces Disciplinary Control Board has the authority to declare a lender off-limits to military personnel, it cannot do so if the lender is not breaking applicable state laws.³⁸ Furthermore, numerous states have failed to enforce their laws when they are broken by lenders targeting only non-resident service members stationed within the state.³⁹ Many lenders have effectively circumvented those few state laws by affiliating via the internet with out-of-state banks based in states like Delaware or Nevada that do not cap rates for loans.⁴⁰

Persistent lenders have found loopholes around outright bans on payday lending, masking the true nature of the services they offer. For example, in New York, where payday lending is illegal, a local business called N.Y. Catalog Sales, located in a mall near a military base, allowed customers to "purchase" \$90 dollars worth of coupons for merchandise in an old catalog chained to the store's counter.⁴¹ A customer simply had to write a check for \$390, which the catalog

³⁴ REPORT ON PREDATORY LENDING, *supra* note 8, at 3.

³⁵ Diana B. Henriques, *Lenders At the Gate: Debtors in the Barracks: Seeing Quick Loans, Soldiers Race Into High Interest-Rate Traps*, N.Y. TIMES, Dec. 7, 2004, at A1.

³⁶ Sandra Jontz, *Pentagon Backs Effort to Cap Interest Rate On 'Payday Loans'*, STARS AND STRIPES, Aug. 15, 2006, available at <http://stripes.com/article.asp?section=104&article=38428&archive=true> (last visited Oct. 17, 2007).

³⁷ *Id.*

³⁸ *Id.*

³⁹ REPORT ON PREDATORY LENDING, *supra* note 8, at 46.

⁴⁰ *Id.* at 47, app. 3.

⁴¹ Henriques, *supra* note 35, at A1.

sales shop would hold until payday, and he would receive the coupons and \$300 in cash.⁴² The scheme was obviously a thinly-disguised attempt to make high-interest loans look like legitimate sales. One military wife who used this service said of the coupons, “We just threw them out . . . [o]bviously, you go there to get a loan.”⁴³

In its own attempt to address the concerns regarding payday lending to military personnel, the payday-advance industry’s national trade association, the Community Financial Services Association (“CFSA”), issued its “Military Best Practices.”⁴⁴ But the guidelines are merely voluntary, providing no penalties or sanctions for CFSA members who do not comply.⁴⁵ Although these guidelines claim to “limit rollovers to four (4) or the State limit, whichever is less,” loan flipping has continued through back-to-back transactions, in which the lender allows the customer to close out the old loan and then immediately re-open a new loan to bypass the rollover limitation.⁴⁶ As Major General Steve Siegfried, a retired Army officer who helped draft the code has said, “enforcement is the key . . . If you don’t enforce it, it’s just a pretty plaque on the wall.”⁴⁷ The industry guidelines also fail to offer any limitation on the interest rates charged for payday loans.⁴⁸

In the past, federal efforts to protect military personnel from predatory lending have met with little success. A longstanding federal law, updated in 2003, the Servicemembers’ Civil Relief Act (“SCRA”), requires interest rates on any debt a service member acquires prior to enlistment be reduced to 6% upon attaining active duty status.⁴⁹ Unfortunately the law creates no such limit on the rates a service member can be charged *after* enlisting.⁵⁰ With little legislation available to enforce, the military has traditionally relied on educating troops through finance literacy classes, but even the DOD

⁴² *Id.*

⁴³ *Id.*

⁴⁴ Tanik, *supra* note 7, at 8.

⁴⁵ *Id.*

⁴⁶ *Id.* at n.27.

⁴⁷ Henriques, *supra* note 35, at A1.

⁴⁸ Tanik, *supra* note 7, at 8.

⁴⁹ Henriques, *supra* note 35, at A1.

⁵⁰ *Id.*

admits that “educational efforts . . . can only go so far.”⁵¹ Lastly, while alternatives to payday loans like those available through the Military Aid Societies are potential solutions for military personnel that are not readily available to civilian consumers, service members are often reluctant to inquire or take advantage of them, due to the social stigma associated with not having one’s finances under control.⁵²

D. Effects on Military Readiness

Predatory lending affects the quality of life and morale of service members, and has demonstrably undermined troop readiness.⁵³ The DOD’s investigation reveals that 80% of Navy personnel security clearance denials and revocations are due to financial issues.⁵⁴ As part of their military duties, many service members must obtain and maintain security clearances that “demand complete and unquestionable integrity.”⁵⁵ The fear and stress that accompanies the burden of unmanageable debt can cause job performance to suffer and can compromise such integrity.⁵⁶ A service member who loses his security clearance can be temporarily removed from his assignment.⁵⁷ Captain Mark D. Patton, USN Commanding Officer at the Navy’s Point Loma, California Naval Base and head of the task force on predatory lending reports that “[b]etween 2000 and 2005, revoked or denied security clearances for Sailors and Marines due to financial problems have increased 1600 percent.”⁵⁸ He believes that now especially, when the country is at war, “this is an unacceptable loss of valuable talent and resources.”⁵⁹

⁵¹ REPORT ON PREDATORY LENDING, *supra* note 8, at 27.

⁵² *Id.* at 29.

⁵³ *Id.* at 45.

⁵⁴ *Id.*

⁵⁵ *Id.* at 86.

⁵⁶ REPORT ON PREDATORY LENDING, *supra* note 8, at 86.

⁵⁷ *Id.* at 87.

⁵⁸ *Id.* (Emphasis added).

⁵⁹ *Id.*

III. The New Federal Legislation and the Defense Department's Enforcement Regulations

Upon reviewing the issue of predatory lending to military personnel, Congress's Armed Service Committee included §670 in the John Warner National Defense Authorization Act.⁶⁰ The resulting statute, titled "Terms of Consumer Credit Extended to Service Members and Dependents: limitations" became effective October 1, 2007.⁶¹ Divided in seven sections, it sets forth the new limitations on lenders who provide loans to military personnel and their dependants ("covered members").⁶² The law also required that the Secretary of Defense to prescribe regulations for the enforcement of these limitations by October 1, 2007.⁶³

In accordance with the modern practice of electronic rulemaking,⁶⁴ the DOD posted its proposed regulations online and opened up a comment period, allowing any individual or organization to review and submit comments on the proposed rules until June 11, 2007.⁶⁵ On August 31, 2007 the final regulations were codified at 32 C.F.R. 232. The following discussion will comment on the law's provisions and the added regulations, each within the context of the seven categories set forth in the statute.

A. Interest

The new federal statute and the DOD regulations limit the interest required on extensions of credit to military personnel and their dependants to: 1) what is agreed to under the credit agreement;

⁶⁰ Limitations on Terms of Consumer Credit Extended to Service Members and Dependents, 72 Fed. Reg. 18, 157 (April 11, 2007) (to be codified at 32 C.F.R. pt. 232), available at <http://a257.g.akamaitech.net/7/257/2422/01jan20071800/edocket.access.gpo.gov/2007/pdf/07-1780.pdf> (last visited Oct. 17, 2007) [hereinafter Limitations].

⁶¹ 10 U.S.C. §987 (2006).

⁶² *Id.* at §987(e).

⁶³ *Id.* at §987(h)(1).

⁶⁴ Michael Hertz, *E-Rulemaking*, DEVELOPMENTS IN ADMINISTRATIVE LAW AND REGULATORY PRACTICE, 2002-2003 (Jeffrey S. Lubbers, ed., A.B.A. Sec. of Admin. L. & Reg. Prac., (2004)), available at http://www.ksg.harvard.edu/m-rcbg/rpp/erulemaking/papers_reports/Herz_E_Rulemaking.pdf (last visited Oct. 17, 2007).

⁶⁵ Limitations, *supra* note 60.

2) what is authorized by applicable State or Federal law; and 3) what is not specifically prohibited by the law itself.⁶⁶

B. Annual Percentage Rate

One of the most radical limitations the new statute sets forth is a cap of 36% on annual percentage rates for credit extended to covered members.⁶⁷ In addition, the DOD regulations specifically define a military annual percentage rate (“MAPR”) to include the following cost elements that are deducted from the proceeds of the credit extended to covered members: “interest, fees, credit service charges, credit renewal charges, credit insurance premiums including charges for single premium credit insurance, fees for debt cancellation or debt suspension agreements, and fees for credit-related ancillary products sold in connection with and either at or before consummation of the credit transaction.”⁶⁸ The regulations, however, provide that the MAPR is not to include fees imposed for actual unanticipated late payments, default or delinquency, because these are fees imposed as a result of contingent events occurring after the loan is consummated.⁶⁹

C. Mandatory Loan Disclosures

The new statute requires that any extension of credit to a covered member, including those extended through the internet, shall provide adequate disclosures of the applicable annual percentage rate, any disclosures already required under the Truth in Lending Act,⁷⁰ and “a clear description of the payment obligations.”⁷¹ Such disclosures are to be made orally *and* in writing, and shall be in accordance with the regulations implementing the Truth in Lending Act,⁷² which require “a separate written itemization of the amount

⁶⁶ 10 U.S.C. §987(a) (2006); 32 C.F.R. §232.4(a) (2007).

⁶⁷ 10 U.S.C. §987(b) (2006); 32 C.F.R. §232.4(b) (2007).

⁶⁸ 32 C.F.R. §232.3(h)(1) (2007).

⁶⁹ *Id.* at §232.3(h)(2).

⁷⁰ 15 U.S.C. 1601 et seq.

⁷¹ 10 U.S.C. §987 (2006).

⁷² *Id.*

financed,” unless the consumer is made aware that he is entitled to such an itemization and declines it.⁷³

The DOD proposed regulations further specify that the following disclosures must be made “clearly and conspicuously” prior to completion of the credit transaction: 1) the applicable MAPR and its corresponding total dollar amount; 2) a clear description of the payment obligations; and 3) a statement expressly identifying the special protections provided and alternatives available to military personnel under the Army Emergency Relief, Navy and Marine Corps Relief Society, Air Force Aid Society or Coast Guard Mutual Aid, including free legal advice upon request.⁷⁴ The regulations clarify that written disclosures must be made in a form the covered borrower can retain a copy of, and that oral disclosure requirements may be met in the case of internet or mail transactions by providing a toll-free telephone number.⁷⁵

D. Preemption

Both the new statute and the DOD regulations clearly state that they preempt any state or federal law, rule, or regulation that conflicts with their provisions, but do nothing to change existing laws that provide additional protections to service members.⁷⁶ They forbid the different treatment under existing state law of military personnel stationed within a state based on their non-resident status.⁷⁷

E. Limitations

The law provides for several restrictions on the terms that can appear in loans to covered members and the way in which they can be maintained.⁷⁸ First, in an apparent attempt to abolish “loan flipping,” the law bans the rollover, renewal, refinancing, or consolidation of loans extended to covered members with the proceeds of other credit.⁷⁹ Loans to covered members may not

⁷³ 12 C.F.R. §226.18 (2007).

⁷⁴ 32 C.F.R. §232.6 (2007).

⁷⁵ *Id.*

⁷⁶ 10 U.S.C. §987(d)(1) (2006); 32 C.F.R. §232.7(a) (2007).

⁷⁷ 10 U.S.C. §987(d)(2) (2006); 32 C.F.R. §232.7(b) (2007).

⁷⁸ 10 U.S.C. §987(e) (2006).

⁷⁹ *Id.*

require them to waive any of the rights to legal recourse they enjoy as service members.⁸⁰ Likewise, the statute bans the use of mandatory arbitration clauses in such loans.⁸¹ It bans the use of checks, access to deposit accounts, allotments, savings, or the title of vehicles as security for loans extended to covered members.⁸² Finally, the statute states that covered members will be given the chance to pay off their loans early, without incurring prepayment penalties.⁸³

The DOD regulations clarify that loan renewals *will* be allowed in cases where they result in more favorable terms to covered borrowers, such as lower MAPRs.⁸⁴ The regulations also make exceptions for the means of securing applicable loans, providing that creditors may: 1) require electronic fund transfers to pay consumer credit transactions; 2) require direct deposit of the covered member's salary as a condition of eligibility for consumer credit; and 3) may take a security interest in funds deposited after the extension of the credit in an account established in connection with the credit transaction.⁸⁵

F. Penalties and Remedies

Both the statute,⁸⁶ and the DOD regulations,⁸⁷ state that a creditor who knowingly violates these provisions can be charged with a misdemeanor, and the credit agreement resulting from such prohibited actions will be void from inception. The statute provides that no agreement to arbitrate a dispute over the extension of consumer credit will be enforceable against any covered member.⁸⁸ Neither the statute,⁸⁹ nor the regulations,⁹⁰ preclude other civil

⁸⁰ *Id.*

⁸¹ *Id.*

⁸² *Id.* at §987(e)(5).

⁸³ 10 U.S.C. §987(e)(7) (2006).

⁸⁴ 32 C.F.R. §232.8(a)(1) (2007).

⁸⁵ *Id.* at §232.8(5).

⁸⁶ 10 U.S.C. §987(f) (2006).

⁸⁷ 32 C.F.R. §232.9 (2007).

⁸⁸ 10 U.S.C. §987(f)(4) (2006).

⁸⁹ *Id.* at §987(f)(2).

⁹⁰ 32 C.F.R. §232.9(b) (2007).

remedies available to service members, including their right to seek punitive damages.

G. Servicemembers Civil Relief Act Protections Unaffected

Neither the statute,⁹¹ nor the DOD regulations,⁹² do anything to limit remedies already available to covered members under the Servicemembers Civil Relief Act, which limits the interest rate that can be charged on any debt a service member incurs prior to entering military service to 6% during the period of military service.⁹³

H. Regulations

In this section, the new statute indicates how the DOD's regulations are meant to flesh out the statutory requirements. It provides that the Secretary of Defense will address 1) what disclosures will be required; 2) the method for calculating the applicable annual percentage rate; 3) the maximum number and types of allowable fees; 4) the full definitions of "creditor" and "consumer credit"; and 5) "[s]uch other criteria or limitations as the Secretary of Defense determines appropriate."⁹⁴ In formulating such regulations, the DOD is to consult with the Federal Trade Commission ("FTC"), Board of Governors of the Federal Reserve System, Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation ("FDIC"), and Office of Thrift Supervision, National Credit Union Administration, and the Treasury Department.⁹⁵ Broad latitude is given to the DOD to determine the scope and impact of the regulations, consistent with the legislative goal of "protecting Service members and their families from potentially abusive lending practices and products."⁹⁶

I. Definitions

In its definition section, the new statute spells out who it will apply to: active duty military personnel under a call or order of 30

⁹¹ 10 U.S.C. §987(g) (2006).

⁹² 32 C.F.R. §232.10 (2007).

⁹³ 50 U.S.C. app. §527(a)(1).

⁹⁴ 10 U.S.C. §987(h) (2006).

⁹⁵ *Id.*

⁹⁶ Limitations, *supra* note 60, at 18, 162.

days or more, and active Guard and Reserve Duty service members and their dependants, including spouses and children.⁹⁷ The term “annual percentage rate” is defined as it is in the Truth in Lending Act,⁹⁸ and the term “interest” is to be construed so as to include “all cost elements associated with the extension of credit, including fees, service charges, renewal charges, credit insurance premiums [and] any ancillary product[s] sold with any extension of credit.”⁹⁹

The statute begins to define “creditor” as a person (or that person’s assignee) who “is engaged in the business of extending consumer credit,” but leaves the definition open to further detail under the DOD’s regulations.¹⁰⁰ The DOD regulations elaborate, stating that the term “person” shall include organizations, corporations, partnerships . . . associations, . . . and any other business entit[ies] who otherwise meet[] the definition given in the Truth in Lending Act.¹⁰¹

Similarly, the law leaves the term “consumer credit” to be defined by the DOD regulations, although it specifically states that the term is not to include residential mortgages or loans made to finance cars or personal property where the purchase is secured by that same personal property.¹⁰² The DOD regulations flesh out this definition, providing that “consumer credit” shall mean credit extended to a covered borrower “primarily for personal, family or household purposes,” and shall include payday loans, vehicle title loans, and tax refund anticipation loans.¹⁰³

IV. Critical Analysis of the new Regulations

A. “Doomsday” Predictions

Proponents of payday loans criticize the new legislation and enforcement regulations, claiming they will prevent payday lenders from turning a profit on covered transactions, and will in turn

⁹⁷ 10 U.S.C. §987(i) (2006).

⁹⁸ 15 U.S.C. §1606.

⁹⁹ 10 U.S.C. §987(i) (2006).

¹⁰⁰ *Id.*

¹⁰¹ 32 C.F.R. §232.3(e) (2007).

¹⁰² 10 U.S.C. §987(i) (2006).

¹⁰³ 32 C.F.R. §232.3(b) (2007).

discourage lenders from loaning to military personnel.¹⁰⁴ They predict that military borrowers will be forced to turn to unregulated internet lenders,¹⁰⁵ pawn shops, or loan sharks.¹⁰⁶ In response to the DOD investigations, Advance America Cash Advance Centers, the nation's biggest payday loan company, actually announced last September that it would no longer offer payday loans to active-duty troops or their families.¹⁰⁷ A representative of the payday industry group CFSA stated that he expected the entire industry to follow suit.¹⁰⁸

Despite these dire predictions, critics of payday loans argue that military personnel will simply be steered toward the more appropriate and beneficial alternatives that are uniquely available to them, like the assistance provided by the Navy-Marine Corps Relief Society or the Army Emergency Relief Program.¹⁰⁹ They argue that although payday lending and other short-term loan options appear to meet a valid consumer need, so do loan sharks, and they've been made illegal.¹¹⁰ Professor Christopher Peterson of the University of Florida, in a comment posted to the e-docket for the DOD proposed regulations, says he believes these "doomsday" predictions are unwarranted threats by the payday lending industry.¹¹¹ He observes that "[e]very time a major change [in] consumer credit law is contemplated, a significant number of creditors and creditor trade association[s] predict that lenders will simply stop making loans, that creditors will go bankrupt, or even that the economy will collapse," and all of these dire predictions have proven wrong.¹¹² He points out that those military personnel will still have plenty of attractive

¹⁰⁴ Jontz, *supra* note 36.

¹⁰⁵ *Id.*

¹⁰⁶ Leo Shane III, *Senators Consider Payday Loan Limits, Criticize Industry*, STARS AND STRIPES, Sept. 16, 2006, available at <http://www.estripes.com/article.asp?section=104&article=39453&archive=true> (last visited Oct. 17, 2007).

¹⁰⁷ *Id.*

¹⁰⁸ *Id.*

¹⁰⁹ Jontz, *supra* note 36.

¹¹⁰ Shane III, *supra* note 106.

¹¹¹ Posting from Christopher L. Peterson to <http://www.regulations.gov/> (Click "Search for Documents;" In the "Document ID" box enter DOD-2006-OS-0216-0040.1; Click Submit), (Feb. 6, 2007) (last visited Oct. 17, 2007) [hereinafter Peterson].

¹¹² *Id.*

alternatives available to them, and the only options likely to be limited are those that borrowers are better off without.¹¹³

B. Potential Loopholes and Unintended Consequences

In light of the demonstrated ability of predatory lenders to circumvent existing state laws, commentators like the Navy-Marine Corps Relief Society have urged the DOD to extend its regulations to all types of lenders and all types of loans, without excluding segments of the banking industry like credit cards and checking overdraft advances.¹¹⁴ The Society argues this is necessary to close any loopholes that might allow predatory lenders to bypass and thereby undermine the protections provided by the regulations.¹¹⁵ Professor Peterson agrees, predicting that “[a]llowing one group of lenders an exemption, will allow the market to flank the entire statute.”¹¹⁶

Alternatively, commentators like the Navy Federal Credit Union (“NFCU”) warn that too broad a definition of “creditor” could overreach the legislative intent and have unintended consequences, such as the reduced availability of beneficial and reasonably priced products and services.¹¹⁷ However, as the U.S. Public Interest Research Group and FDIC Chairman Shelia Bair have stated, “any legitimate inadvertent problems [discovered] in th[e] rulemaking can easily be ironed out in [the DOD] regulations without Congress reopening the law.”¹¹⁸ This argument is a compelling reason for the DOD regulations to begin with a broad scope that can later be trimmed down as their effects are measured.

¹¹³ *Id.*

¹¹⁴ Posting from Steve Abbot to <http://www.regulations.gov/> (Click “Search for Documents;” In the “Document ID” box enter DOD-2006-OS-0216-0018; Click Submit), (Feb. 5, 2007) (last visited Oct. 17, 2007) [hereinafter Abbot].

¹¹⁵ *Id.*

¹¹⁶ Peterson, *supra* note 111.

¹¹⁷ Posting from Cutler Dawson to <http://www.regulations.gov/> (Click “Search for Documents;” In the “Document ID” box enter DOD-2006-OS-0216-0129; Click Submit), (Feb. 12, 2007) (last visited Oct. 17, 2007)[hereinafter Dawson].

¹¹⁸ Posting from Edmund Mierzwinski to <http://www.regulations.gov/> (Click “Search for Documents;” In the “Document ID” box enter DOD-2006-OS-0216-0043.1; Click Submit), (Feb. 6, 2007) (last visited Oct. 17, 2007).

C. Meaningful Disclosures

Other comments on the new regulations express concerns not with how the regulations themselves are drafted, but with how they will be implemented. For example, the NFCU has emphasized the need for meaningful disclosures to military personnel, not simply technical compliance with the specifics set forth in the law and regulations: “In many cases, consumers do not take the time to read and understand the content of the information overload . . . they may not understand their responsibilities and obligations or the impact of their decisions on their future finances.”¹¹⁹ Disclosures must be developed that are effective for the specific consumers they are meant to protect, and should truly inform, rather than obscure.¹²⁰ The NFCU makes a very credible recommendation, asking that the regulations provide mechanisms for testing the effectiveness of such disclosures in an effort to continually modify and strengthen them.¹²¹

V. Consumer Impact

As discussed, “doomsday” predictions that the new regulations will leave military personnel without any real alternatives for short-term loans are as unfounded as predictions that the restrictions will wreak havoc on the lending industry and put payday lenders out of business. Military personnel do not choose predatory offerings like payday loans because they are the best financial option, but because they are convenient, fast, and allow them to hide their financial troubles and the accompanying social stigmas involved. Military families will be better off facing the realities of their financial situations and seeking real help from military aid organizations. As Kimberly Warden, Vice President for Federal Affairs at the Center for Responsible Lending has said, “[t]he sooner these products are away from bases, the better.”¹²²

In fact, the new regulations are likely to encourage service members to take advantage of existing short-term loans at lower interest rates provided by credit unions. The NCFU believes the regulations will help them compete in this market. The NFCU stated, “given reasonable time to make those changes, we see no significant

¹¹⁹ Dawson, *supra* note 117.

¹²⁰ *Id.*

¹²¹ *Id.*

¹²² Shane III, *supra* note 106.

or lasting adverse impact on the credit union . . . [c]onversely, this law may be very positive for credit unions and their members by encouraging persons who use predatory lenders to seek loans for provident purposes from their credit unions. . . .”¹²³

Finally, extending these protections only to service members at this point makes sense, not only because these borrowers have been specifically targeted by predatory lenders, but because states have not adequately enforced their laws when it comes to non-resident service members stationed within their borders. Service members have a safety net of programs developed specifically for them to fall back on that the general population of civilian payday borrowers currently does not. However, the experience of implementing these regulations and tracking their success is bound to have some trickle-down effect on consumers in general. If the critics’ “doomsday” predictions subside after the regulations go into effect, there may be less resistance to the extension of important protections against predatory lending for all consumers.

VI. Conclusion

In conclusion, the predatory lending industry, including payday lenders, car title lenders, tax refund advance lenders, and rent-to-own operations, have blatantly targeted military personnel whose low pay and service obligations make them already vulnerable to short-term, high interest loans. They have done so through strategic geographic placement around military bases and misleading affinity marketing techniques that lead borrowers to believe their services are sanctioned by the military. Military borrowers can easily become trapped in a spiral of debt that affects military readiness in general, while wreaking havoc on their personal and financial lives in particular. Past efforts to protect service members, including various state laws, education efforts, and limited federal legislation have proven ineffective.

The new federal statute, adopted in October 2006 and effective as of October 1, 2007, provides real protections for this country’s military personnel. Although accompanying regulations may need subsequent fine-tuning, and although their effectiveness should continue to be monitored upon implementation, the comments provided during the e-rulemaking process demonstrate the value

¹²³ Dawson, *supra* note 117.

these regulations can provide to service members, members of the lending industry that offer truly beneficial services, and consumers in general. The approved regulations should be strictly enforced to preserve their intended benefits, and their effects monitored to allow lawmakers to make informed decisions concerning the potential effectiveness of similar laws governing lending practices to civilians.