

**Written Testimony**  
**Of**  
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**Before the**  
**Senate Committee on Banking, Housing, and Urban Affairs**

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## Introduction

Chairman and members of the Committee, thank you for the opportunity to speak in support of the *Department of Defense Report on Predatory Lending Practices Directed at Members of the Armed Forces and Their Dependents* and to illustrate the problems and proposed solutions in the report with the experiences of military families I represent in Florida.

Since 1988, I have been a consumer protection attorney with Jacksonville Area Legal Aid, Inc. and represent low income consumers in Duval County. I am co-author of a law review article titled “The Two-Tiered Consumer Financial Services Marketplace: The Fringe Banking System and its Challenge to Current Thinking About the Role of Usury Laws in Today’s Society,” published in the *South Carolina Law Review* in 2000. This widely quoted article covers the high cost loan products detailed in the Department of Defense report to Congress. I serve on the Jacksonville Bankruptcy Bar Association Board of Directors and have been a trainer for Judge Advocates, legal officers and Senior Leadership at Naval Air Station Jacksonville.

Duval County, FL is home to Jacksonville Naval Air Station and Mayport Naval Station where about thirty thousand service members plus their families and retirees live and work. Over the years I have represented many of these Sailors and their dependents as well as veterans who have fallen victim to the predatory loan practices described in the

DOD Report to Congress. Today I will use their stories to put a face on the problems identified in the Department of Defense report and to support the recommended solutions to those problems.

#### Why military consumers are ideal customers for quick cash lenders

Despite their moderate incomes, many Service members are young and financially inexperienced, with young families and tight budgets. They are attractive to lenders because their pay is certain, their residence is easy to find and they live in concentrated areas. They have stable and steady employment and, as members of the Armed Forces, unlike civilian borrowers, they are easy to collect from because the lender routinely contacts their employer pre-judgment. Service members must comply with the Uniform Code of Military Justice and could lose rank, miss opportunities for advancement in rank and pay, and could lose their jobs for failure to honor their debts.

#### Military pay arrangements benefit lenders

Members of the Armed Forces are required to maintain bank accounts in order to receive direct deposit of their federal pay. This makes them attractive to payday lenders whose only qualifications for quick cash loans are a steady source of income and an open bank account. Because they must have a bank account, Service members have added incentive to pay additional sums to renew loans in order to keep the checks provided as security from being returned for insufficient funds. The Uniform Code of Military Justice penalizes a service member's failure to make good on a check drawn on his or her bank account. Many, if not most, lenders can and do ask military borrowers to sign over

electronic access to their bank accounts to repay loans. Some lenders require their loans to be repaid by allotment of military pay, which means that funds are taken out of their pay and sent to creditors before the Service member has an opportunity to use the money to pay rent or utilities. This is a form of payment that is supposed to be voluntary and a convenience to the Service member but has been turned into a way to ensure that high cost lenders get paid before funds are available to pay pressing bills or feed the family. A few lenders even require borrowers to sign wage assignments to insure payment is made timely, despite the federal prohibition on wage assignments in loans to enlisted Service members.

While these Service members have unique features, such as needing to prove financial responsibility, to strive for advancement in rank and pay, and to preserve security clearances, their experiences with predatory lending are replicated in low to moderate income families in civilian life. The Department's report, in many ways, describes the plight of all low to moderate income consumers who struggle to make ends meet in a predatory lending environment.

In my testimony, I will highlight three main points:

1. Predatory loan products and services are expanding rapidly, including quick cash loans offered in exchange for a personal check to be deposited next payday, loans secured by the free and clear title to the family vehicle, and installment loans repaid by military allotments or electronic access to the bank accounts Service members are require to have.

All of these loans place important assets at risk, come at a steep cost, and often trap borrowers in repeat borrowing or renewals. These products also do not provide even the compliant consumer with a credit history that helps them escape from this choice of borrowing. High cost predatory lenders target service members by location, affinity marketing, presence on the Internet, or because they are widely available in the communities where military families reside.

2. Service members are not being protected by most states, either because high cost lenders have been carved out of usury or loan laws, or lenders claim that state credit laws do not protect nonresident borrowers such as Service members stationed in the jurisdiction, or because lenders have exploited every loophole to evade consumer protections. High cost loan contracts are grossly one-sided and include unilateral, mandatory arbitration clauses to deprive Service members of their day in court and limit their remedies, both of which are the cornerstones of the American justice system they fight to preserve. Congress must step in to protect Service members.

3. Service members are disproportionately targeted and punished by the products and practices of high cost lenders who harass them, their families and those in their command and who threaten criminal prosecution, court martial, loss of rank and pay, loss of security clearance and dishonorable discharge. Service members fear the consequences of failure to make good on checks used to get payday loans, and facing automatic and electronic withdrawal of money from their accounts are forced to juggle finances to stay afloat. They fear the loss of the family car whose title is pledged for loans. They fear the

lender retaliation resulting from the cancelling of an allotment given to a lender. This struggle leads to stress, to loss of morale and impedes military readiness in addition to harsh financial consequences felt by the entire family. The practices and problems described in the DOD Report come alive in my clients' stories.

- Mr. Hubbell and his wife are both service members. You may have seen their story on a recent ABC News program. Due to the costs of his wife's illness and her inability to work, they took out a payday loan which led to thousands of dollars in outstanding loans from both payday lenders and installment loan companies. The more they paid, the more they owed and have repaid tens of thousands of dollars. One loan led to another because they had to keep borrowing more money to avoid the threats of criminal prosecution and the consequences of the lender contacting Mr. Hubbell's command. Over a five-year period of time, they were forced to borrow just over \$10,000 and still have a monthly payday loan debt of just over \$3,500. The Hubbells still owe over \$12,000 on loans, most of which only went to pay off other loans and provided no benefit to the Hubbells except for digging them deeper into debt. Mr. Hubbell is an air traffic controller and felt he had no option but to stay on this debt treadmill because of his fear of the real danger of losing his security clearance and his rank.
- Another of my clients borrowed from a sham lender who pretended to sell Internet access to cloak a criminally usurious loan. When he was unable to keep up with payments, the lender directly debited his account for more than the

amounts needed to pay off his loan. The lender also harassed him on his ship and called his superior officers. He was faced with not having enough money for groceries and rent for his family, including three children.

## **Problems Identified in the DOD Report**

### **1. Predatory loan practices and unsafe credit products are high risk for military borrowers**

The Report describes the same types of high-cost, high-risk loan products that we addressed in the law journal article about the two-tiered financial services market: Payday loans, rent to own, car title loans, high cost installment loans, and refund anticipation loans. From my experience helping low income and military consumers, I concur with the Report's description of the lenders' extreme high costs and their unsafe and unsound lending practices. I also concur with the description of the risk to borrowers' assets. Lenders require borrowers to grant them electronic access to their bank accounts as a condition of getting a payday loan at a store or via the Internet or to borrow from a military installment lender. As a result, consumers lose control of their bank accounts and rack up multiple fees when lenders make repeated efforts to collect on the loan by electronically accessing their bank accounts multiple times in one day for just one loan.

Predatory lending is not committed only by one class of lenders. Even banks have begun to join the fray of those lending at triple digit rates. Two banks are offering "account

advances” that work just like a payday loans: the bank advances up to \$500 for a short, typically two week loan that must be paid back on the next payday, at annual rates up to 500%. In North Little Rock, Arkansas, near Camp Robinson and Camp Pike, ACE Cash Express partners with First Bank of Delaware to offer an installment loan at a 390% APR rate. The bank can violate Arkansas’ constitutional 17% usury cap because banks are exempt from state regulation.

The high risks to military borrowers who must maintain bank accounts and who rely on their military pay are illustrated by a Navy borrower I represented.

- Mr. M had an installment loan through a “military” lender that required automatic access to his bank account for electronic payment. When he did not make a timely payment, the lender “hit” his bank account **eleven times** in one day, causing hundreds of dollars in late fees, NSF fees and other bank charges.

Lenders often require the borrower to sign a military allotment, which permits the lender to be paid directly by the Department of Defense out of the Service member’s pay before funds are deposited in the bank. Allotments to pay consumer debt are supposed to be a convenience for the Sailor, payday and installment lenders turn this convenience into a mandatory wage assignment which is prohibited by federal law for enlisted personnel. The allotment becomes another method used by the payday lender to put the Service member at risk.

- Ms. W obtained a loan from a “military” lender that was marketed online. The lender required her to pay them through a military allotment check. They threatened to contact her Command if the allotment was redirected. This put Ms.

W in a bind because the costs were so high for the loan that the allotment took away money she needed for food, transportation to and from work and utilities.

Deceptively marketed car title loans have also been problematic for my clients. In these loans, borrowers sign over the free and clear title to their vehicle to secure loans for a fraction of the vehicle's value. Typically these loans must be repaid in full at the end of the month to avoid repossession of the family's transportation. We had a plague of title loan abuses in Florida until the Legislature finally imposed a reasonable 30 percent interest rate cap on these secured loans. Although Florida now caps these rates, the Report maps show that title loan sales outlets are still located in Jacksonville to channel customers to lenders across state lines in Georgia where title lenders are permitted to charge 300 percent annual interest.

- I represented several Sailors who were in constant fear of losing the family's only means of transportation and their only means of getting to work. In addition to being responsible for sound financial decisions, Service members must also be at work on time. The stress of a potential loss of transportation left one aircraft mechanic constantly distracted while trying to take care of Navy aircraft.

## **2. Predatory Lenders Target Military Borrowers**

The Report includes a set of maps created by Professor Steve Graves from California State University at Northridge, illustrating the clustering of payday lenders, installment lenders and a few title loan outlets around military bases in Duval County. In addition, payday lenders that do not explicitly "target" the military have a big presence in the

commercial areas of Jacksonville. For example, the largest national chain, Advance America has twenty-nine outlets in Jacksonville, Orange Park, and Atlantic Beach yet stated that only about five percent of its borrowers in Duval County are members of the military or their spouses.

The Report also includes a brief survey of online lenders and notes there are millions of “hits” representing companies that appear when someone uses “military” and “loans” as their search terms. Some of these sites are designed to appeal to Service members with photos of Service people, flags, patriotic symbols, and military-sounding names. Other online lenders that appear in searches market to the general public but include “military” pages to attract more hits from Service members.

The problems for military borrowers come from both lenders that wrap themselves in the flag and those that market generally to cash-strapped consumers either in communities where Service members and reservists’ families live or through websites available to Service members anywhere around the world where they have access to the Internet. The loans are just as expensive and risky for Service members whether made by a lender with “military” in the title or by a national chain marketing to the entire community.

My clients tell me that they are influenced by loan ads that include military trappings. They think advertisements appearing in local Navy papers have been approved by the military.

- Mr. M and Ms. W are both in the Navy and are stationed at NAS-Jax. They each responded to advertisements in the local Navy newspaper and on the Internet by companies called Loans 4 Military and Military Financial Network, Inc. They both thought that the lenders were approved by the Navy because of their names, their patriotic web sites and because they were advertised in the Navy paper. The lender advertised a much lower rate than that which was actually provided. As a result, the borrowers were left with insufficient funds to pay their bills because these lenders required repayment by allotment. They had to take more loans to cover the bills that were not being paid because of the allotments.

### **3. High cost loans, abusive collection practices, and the debt trap**

The Defense Report describes the high and deceptively marketed costs, illegal collection practices and repeat borrowing trap that results from predatory lending to Service members.

- The cost of payday loans for my clients over the years has ranged from 390 percent to 906 percent.
- One of my clients had an installment loan with a disclosed interest rate of 17% while the true but undisclosed interest rate was 102%.
- Mr. N who is in the Navy obtained a title loan deceptively marketed as the sale and buy back of his motor vehicle. The lender hid the 300 % rate charged because the Florida Legislature had reduced the interest rates that title lenders could charge from 264% to 30%.

- I regularly see clients who have loans with an installment lender which deceptively markets its products to Service members and claims to provide low interest rates. For example, the disclosed rate in one \$1,000 loan was 19%. The lender also required the borrower to pay \$475.95 for insurance that provided absolutely no real benefit for the borrower. The insurance was actually additional interest disguised as a real “insurance” product.

The Department of Defense Report includes results of this year’s Defense Manpower survey and questions about payday loan use. Those Service members who admitted to using payday loans reported an average of 13 transactions last year (including new loans and loan roll-overs). This loan use pattern is at the top of the range for average transactions per borrower as reported by publicly-traded lenders and state regulators who collect that data, as noted in the Report. If a consumer pays for thirteen \$350 two-week payday loans at a cost of \$15 per \$100, they would pay \$682.50 in finance charges to use \$350 for twenty-six weeks of the year.

It isn’t just the high cost of payday loans that springs the debt trap. Failure to pay or renew a loan means that the check written to secure the loan will bounce and set off a cascade of bounced check fees charged by both the payday lender and the consumer’s bank, not to mention the adverse impact on the borrower’s credit report as a result of the perceived failure to maintain the bank account.

- Mr. K spent his entire day off going from payday lender to payday lender to keep from having his checks bounce. At one time, he was trying to juggle nine loans.

This is the same experience that a witness reported to Senator Lieberman at his 1999 forum on payday lending here in the Senate.

Coercive collections are made easy due to the terms included in payday loans, car title loans and installment loans.

- A payday lender sent one of my clients, who was required to allow electronic access to his bank account in the loan transaction collection, letters written by the lender on State Attorney letterhead. In these unauthorized and illegal collection letters, the lender threatened criminal prosecution when he did not have sufficient money to pay the loan in full.
- Mr. W borrowed from Military Financial Network which included language in their documents threatening Court Martial, imprisonment and a dishonorable discharge if he did not pay.
- Mr. G contacted me via email from an undisclosed location at sea. He was worried about his wife and family because of his outstanding payday loan debt. Due to threats she had received, he was afraid that the payday lender would put his wife in jail, leaving their two babies without a parent.

#### **4. Service members sign away their rights in the credit market**

Every contract I see includes a binding, unilateral pre-dispute mandatory arbitration clause which is especially burdensome to military borrowers who are not able to pay the costs associated with arbitration or travel to participate in arbitration. For example, Mr. W, who had the Military Financial Network loan while stationed in Florida, was

prohibited from suing MFN and, if he thought they acted illegally, was required to arbitrate his dispute in Delaware. Therefore, he effectively had no remedy when MFN debited his account eleven times in one day, used a contract threatening Court Martial, and threatened him while at work.

#### **5. Consumer Protections are evaded, not enforced, or nonexistent**

Thirty-nine states have carved payday lenders out of usury or small loan rate caps or repealed their credit restrictions for all licensed lenders. Half the states permit title lenders to make short term cash loans at an average of 300% APR. In about half the states, installment lenders claim that state credit code or rate caps do not apply to nonresident service members stationed in that state. My home state of Florida is now in Federal court over the claim that Pioneer Military Lending is not licensed as a small loan company and does not comply with Florida protections. Installment lenders that make loans to military borrowers are not licensed or supervised in North Carolina or Virginia. Just recently California regulators withdrew its licensing waiver for one military lender, deciding that there was a public interest in supervising these companies.

Over the years I have witnessed payday lenders used every trick in the book to escape real protections.

**Hiding behind the check cashing statute.** In Florida, payday lenders tried for years to operate under the state check cashing law to avoid compliance with the state small loan law and credit protections. Eventually, Florida allowed payday lenders a safe harbor,

permitting rates up to 390% APR for a \$100 loan. Even with such generous rates, some lenders have attempted to evade Florida law.

**Rent-a-bank evasion of state limits** were used by some of the largest payday lenders until the Federal bank regulatory agencies halted that tactic. Cash America, a publicly traded pawn and loan chain, used a series of out of state banks as a partner, claiming that they did not have to comply with Florida regulation. Jennafer Long borrowed money from ACE Cash Express while it partnered with Goleta National Bank to make loans at rates that exceeded Florida caps. The company repeatedly debited her bank account and harassed her supervising officers and threatened her with criminal prosecution when she was unable to repay on the due date. We sued and got a favorable ruling from the Federal court. Thankfully, the Comptroller of the Currency, the Office of Thrift Supervision, the Federal Reserve and the FDIC put a stop to the misuse of the charters of financial institutions through strict guidelines, safety and soundness enforcement and close examination of partner institutions.

**Sham transactions to cloak loans:** There is no limit to the lengths some lenders will go to loan money to consumers at outrageous terms. Mr. B, a low-ranking Navy member, entered into a loan transaction with Florida Internet. The loan was characterized as the “sale of the right to use the Internet” for hourly increments. The loan was cloaked as a “rebate” for buying Internet time. The lender required direct electronic access to the borrower’s bank account. This company was hiding interest rates which exceeded 400%, which made the loans criminally usurious and well above the 18% general loan rate in

Florida. The same lender used a “catalogue” sales model to avoid Florida usury and payday loan law and was sanctioned by the State Attorney in Pensacola, another Navy town. The lender has been convicted of racketeering charges and is awaiting sentencing after decades of predatory lending from Washington to New York’s Fort Drum.

**Claim to broker loans for other lenders** under the credit service organization model:

Cash America is claiming to be a credit services organization as a ruse to “broker” payday loans in Florida for an Ohio based finance company, which may be a Cash America subsidiary. Cash America guarantees repayment of the loans to the Ohio company, which should take them out of the definition of a credit services organization and put them in the category of a loan guarantor. Cash America’s loans cost \$18 per \$100 for the “broker fee,” plus interest charged by the purported lender. This makes Cash America loans even more expensive than Florida’s limits for payday loans. I believe that this arrangement does not comply with Florida’s Credit Services Organization Act and is simply done to charge Florida borrowers higher rates than even the state payday loan law allows.

**Attempt to avoid state protections by doing business online**

I recently filed a lawsuit against an Internet lender, Sonicpayday.com. This lender is available only on the Internet and charges interest rates as high as 900%. They do not allow the grace period provided by Florida law and encourage roll over transactions (paying off an outstanding loan with another more expensive loan). Sonic also requires its borrowers to sign a “voluntary” wage assignment. When my clients were unable to

pay these high cost loans, Sonic contacted their employers and demanded the employers pay Sonic directly. They also contacted the Service member's chain of command when he told them he could not pay on time. Sonic loans have a term of two weeks or less. The short term makes the loan even harder to pay back.

**Noncompliance with protections.** In July, Florida regulators took EZPawn to court over its failure to get a license to make payday loans. The Office of Financial Regulation alleged that EZPawn Florida, Inc. unlawfully blocked examiners from inspecting its loan papers and other records. This company, one of the large publicly traded payday loan and pawn chains, has at least eighteen locations in Florida

The public record is replete with instances of large payday loan companies violating state consumer protection laws. This summer the Washington Department of Financial Institutions filed a case against Check'n Go for continued violation of state rules for payday lenders. Illinois Department of Financial Institutions fined Advance America earlier this year for violating the new Illinois law. West Virginia's Attorney General settled a case against Advance America for debt collection tactics used by its Ohio stores with West Virginia consumers. Arizona's Attorney General brought a case against a payday lender for threatening criminal prosecution for nonpayment. The Colorado Attorney General settled a case against an Internet payday lender that failed to comply with Colorado law. The North Carolina Banking Commissioner ruled that Advance America violated its small loan law while brokering loans through a series of out-of-state banks.

### **Industry “best practices” voluntary codes fail to protect consumers**

Trade group “best practices” codes of conduct are more public relations than consumer protection. The CFSA “Best Practices” do not call on their members to cap interest rates, to stop enticing consumers to write checks without money in the bank, to consider ability to repay in extending credit, or to provide affordable repayment terms for their loans. Instead, the trade group’s voluntary guidelines call for lenders to obey the Truth in Lending Act and state law relating to disclosures, to refrain from threatening criminal prosecution if a check used to get a loan is returned unpaid, and calls for a 24-hour right to cancel the loan by returning the amount borrowed. Even where the guidelines appear to offer the protection of a four roll-overs limit (unless state law requires less), these companies do not consider back-to-back loans as roll-overs restricted by this limit. Their Best Practices call for borrower responsibility but says nothing about lender responsibility to make appropriate loans.

One of my clients had a bad experience with a payday lender which bragged about being a member of CFSA in its contract and claimed that it followed CFSA’s Best Practices:

- Ms. Griffin is a Navy wife who has a payday loan with Advance America in Florida, which, as stated above, is a state that requires licensed lenders to grant at least a 60-day grace period with no additional fees, charges or costs if a borrower seeks credit counseling. Despite the grace period and a prohibition on “roll-overs” in her contract, she was required to roll over her loan when she could not pay. When she went to pay it off, she was \$45 short, not realizing that she would

be charged another fee to roll over the loan. Advance America refused the grace period even after she told them she already had the counseling at the Navy Marine Corps Relief Society, an authorized State of Florida Deferred Presentment Provider counseling agency. The director of NAS Jax NMCRS, Ret. Capt. Dave Faraldo, called the lender only to be told they did not have to talk to him and did not have to provide the grace period. You might think this was a matter on an inexperienced employee; however, the Advance America employee said she had been an employee trainer for eight years and they never had to provide the grace period. When I provided a signed release that I was Ms. Griffin's attorney, the Advance America staffer refused to speak to me about the legally-required grace period on her account.

The organization also promotes its "military best practices" as all the protection military borrowers need. A close examination reveals no cap on interest rates; no ban on check holding or electronic access to bank accounts; no prohibition on mandatory arbitration clauses, and no ban on waiver of rights or access to the courts. Instead, the code prohibits after-the-loan practices that are already largely addressed by Department of Defense rules, the Servicemembers Civil Relief Act, or are promises that sound good but deliver little. Payday lenders use the borrowers' automatic access to bank accounts and checks to collect, not garnishment, in most cases. Federal law provides significant protections against garnishment of wages for enlisted personnel. Officers are directed by DOD not to assist creditors in collecting "exorbitant" debts. The other weak provisions of the CFSA Military Best Practices, adopted in 2004, call for honoring repayment agreements

negotiated by credit counselors, providing educational materials including a brochure, and maintaining a web site. Since these guidelines have been in effect for over two years, it is obvious their application did not prevent the serious problems identified by the Department of Defense in last month's report.

### **Solutions Needed**

I agree with the reforms urged by the Department of Defense to protect military borrowers and believe these protections are needed by all consumers struggling to make ends meet.

1. Rate cap which the Senate has already enacted as part of the 2007 Defense Authorization bill, now in conference with the House. DOD calls for a 36% APR cap to include all fees, premiums, other charges. This is the typical state small loan rate cap and is double the federal interest rate cap for Federal credit unions. It is six times the interest rate for loans held by Service members prior to joining the military. The Talent-Nelson amendment places a federal ceiling on interest rates (helpful for those states that neglect to protect nonresident Service members who live in their states) but permits states to provide more protection.

2. Loans should not be based on key assets for families. This puts too much risk into borrowing, fosters coercive collection tactics, and encourages consumers to take desperate steps to avoid losing those assets. S. 1878, introduced by Senator Akaka,

would prohibit lending based on solicitation of unfunded checks or electronic access to bank accounts. It is already illegal for lenders to require consumers to pay debts through periodic electronic payments. This protection should be extended to single payment payday loans. No lender should be permitted to require a Service member to sign an allotment to military pay, providing a *de facto* wage assignment to lenders.

3. Service members deserve to have the full range of American rights when dealing with creditors. They should not be asked to waive their rights under state and federal law or be forced to accept binding, unilateral mandatory arbitration. No one should have to sign that they will not sue a lender for illegal practices and will not join a class action lawsuit. Often class litigation is the most efficient means for both parties to litigate illegal practices relating to hundreds of cases involving relatively small sums. Also, no one should be required to agree to pay the lender's expenses to remove them from a class or promise they will not file for bankruptcy in the future. I agree with DOD that "waiver is not a matter of 'choice' in take-it-or-leave-it contracts of adhesion."