



Testimony of Dr. William O. Brown, Jr.

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before the

U.S. Senate Committee on Banking, Housing and Urban Affairs

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Comments on the Department of Defense's Report on Predatory Lending Practices

Directed at Members of the Armed Forces and Their Dependents

Chairman Shelby, Senator Sarbanes and members of the Committee, thank you for the opportunity to speak to you today about the Department of Defense's report on lending practices directed at members of the armed forces. I am currently an Associate Professor in the Department of Accounting and Finance at the University of North Carolina at Greensboro and an economist by training. Over the past two years I have conducted research on payday lending, military compensation and the use of payday loans by military personal. In June of this year, I released a study with my colleague, Dr. Charles B. Cushman, Jr. from The George Washington University, of payday loan attitudes and usage among enlisted military personnel. Our results are cited on several occasions in the Department of Defense Report.

I would like to take this opportunity to share with you some of our key findings and then raise some of my concerns about the methodology and analysis in the recent Department of Defense report. Our study surveyed U.S. enlisted personnel in four branches of the armed services regarding their attitudes toward, and usage of, short-term credit, including payday loans. Our survey is the first systematic survey of enlisted military personnel regarding their economic circumstances and attitudes toward short-term credit. Our analysis is based on empirical data that we collected through a random sample of enlisted military personnel who live near military bases in the United States.

I want to briefly discuss some of our findings that I believe are relevant to the discussion today. Our results indicate that 13% of the 460 enlisted personnel that lived around military bases and responded to our survey had obtained payday loans in the previous year. It is important to note that these numbers are only for enlisted personnel and not all military personnel. It is suggested in the Department of Defense report and elsewhere that our number indicates a higher incidence of payday loan use by members of the military than the general population. However, our results do not provide such a comparison. One would need to compare enlisted personnel with a civilian population of similar age and income in order to make such a comparison. Otherwise, it is an apples to oranges comparison.

Military borrowers report that they use payday loans to help pay bills, for auto and home repairs, family emergencies, relocations and other short term cash flow disruptions. This usage is very similar to that reported by civilian users of payday loans.

The military enlisted personnel who have had a payday loan repay them more quickly than their civilian counterparts. Forty-nine percent of military payday loan borrowers have had two or fewer loans in the last 12 months, and 78% have had four or fewer loans. A 2001 study indicated that only 35% of civilian payday loan users had fewer than four loans. There is little evidence that military users of payday loans use these loans as a substitute for longer term credit. Given the relative low overall default rate for such loans in general, the claims of some opponents to payday lending that payday loans are a threat to military readiness appear unsupported.

Payday loans are but one form of short-term credit available to military personnel. Bounced-check fees, late fees and utility reconnect fees can be and are often more costly than a payday loan. The majority of military survey respondents reported that they choose a payday loan for convenience related reasons. In addition some military personnel reported a lack of alternative options or lack of knowledge about alternative sources of short term loans indicating that the military may need to do a better job of educating enlisted personnel about short term credit options.

As potential decisions regarding the cost and availability of consumer credit by members of the armed services are considered today, I sincerely believe that our comprehensive study, which I have only briefly reviewed here today, would be a valuable body of information to inform your views on this topic. For this reason, I am submitting a copy of our full study for the record today.

As to the Department of Defense report, I have several points of concern and disagreement with the conclusions drawn.

From anecdotes portrayed in the news media and mentioned in the Department of Defense report, one could have the impression that the majority of military personnel are deep in debt, the victims of aggressive payday loan issuers. I am sure many of the anecdotal stories are true. However, anecdotes only tell us what can happen in some cases, they fail to give us a bigger picture view or tell us how often these things happen. There is nothing in the Department of Defense report to give any indication of the prevalence of problem borrowing by military personnel.

There are certainly some military personnel with financial problems and service members with financial problems may have obtained payday loans, but there is no evidence that payday loans are the cause rather than a symptom of these financial problems. This causation connection is completely missing in the Department of Defense report.

Consumers make purchasing decisions based on a number of factors: price, convenience and opportunity being chief among them. This Department of Defense report fails to consider that service members either choose payday loans either because they lack a better alternative or because they lack available information about better alternatives. In either case, the Department of Defense needs to do a better job of working with financial service firms to provide products that meet the needs of military personnel and educating military personnel about the availability and use of those products.

Finally, the Department of Defense's recommendation to reduce the maximum permissible charge on payday loans to 36% would likely drive lenders out of the market. The problem is that marginal cost of providing small consumer loans is high. This is why so many banks and financial service firms fail to provide such products. When you take choices away from consumers, prices go up, not down. Again, members of the military have a demonstrated need for access to short-term credit. The likely impact of such a rule would be to make military personnel with short term credit needs significantly worse off.

Mr. Chairman and members of this Committee, I thank you for the opportunity to appear before you and will be happy to answer any questions you may have.