Report on the Military Lending Act and the Effects of High Interest Rates on Readiness

Response to House Report 116-442, Title V, pg. 121

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Office of the Under Secretary of Defense for Personnel and Readiness

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INTRODUCTION

The Department of Defense (DoD) submits this report in response to Title V, page 121, of House Report 116-442 on the National Defense Authorization Act (NDAA) for Fiscal Year (FY) 2021. House Report 116-442 which requests that "the Secretary of Defense, in consultation with the Secretary of the Treasury, to submit a report to the House Committee on Armed Services … on a Military Annual Percentage Rate lower than 30% and its impact on military readiness and servicemember retention."

Congress passed legislation in section 670 of the NDAA for FY 2007 (Public Law 109-364) that is commonly known as the Military Lending Act (MLA). The MLA established terms of certain types of consumer credit offered to covered borrowers (Service members on active duty and their eligible dependents), including limiting the cost of credit to a 36 percent annual percentage rate, requiring specific lending disclosures, and prohibiting certain lending practices such as requiring a military pay allotment or waiving rights under the Servicemembers' Civil Relief Act. The Department issued implementing regulations in 2007 and revised regulations in 2015 in response to amendments to the MLA in the NDAA for FY 2013. The MLA statute established the Military Annual Percentage Rate (MAPR), which may not exceed 36 percent, and the Department's regulations, consistent with the statute, defined the MAPR and its computation.

The Department believes the MLA and its associated MAPR support the financial readiness of Service members by ensuring covered borrowers are not subject to unfair credit practices that can negatively impact financial readiness and, in turn, military readiness. In particular, the MAPR prevents Service members from becoming trapped in a harmful cycle of debt resulting from significantly high interest rates typical of credit products such as vehicle title loans, payday loans, and certain installment loans that were historically targeted at the military population. The Department's definition of the MAPR supports the intent of the MLA by requiring lenders to include designated fees and add-on credit products in the calculation, thereby preventing lenders from shifting costs from interest to such fees and products as a means to evade the MLA's cost of credit limit.

The next section of this report describes the MLA, the MAPR, and the Department's current assessment of the effectiveness of the MLA. The subsequent section describes the Department's analysis of potential impact on Service member readiness and retention if the MAPR were to be reduced below 30 percent. The report only considers a change to the MAPR limit and assumes all other protections of the MLA statute and regulation remain the same.

THE MILITARY LENDING ACT AND THE MILITARY ANNUAL PERCENTAGE RATE

Predatory Lending and Service Members

Section 579 of the NDAA for FY 2006 (Public Law 109-163) directed the Secretary of Defense to submit a report to Congress addressing:

(1) A description of the prevalence of predatory lending practices directed at Service members and their families.
(2) An assessment of the effects of such practices on Service members and their families.
(3) The Department's strategy and programs to educate Service members and their families regarding such practices.
(4) The Department's strategy and programs to reduce or eliminate the prevalence and negative effects of such practices.
(5) Recommendations for legislative and administrative action to reduce or eliminate such practices.

In August 2006, the Department submitted its "Report on Predatory Lending Practices Directed at Members of the Armed Forces and Their Dependents" (2006 Report). The 2006 Report described how predatory lenders sought out young and financially inexperienced Service members with reliable income but limited savings and credit history. These lenders provided short-term or installment loans—specifically, payday loans, vehicle title loans, tax refund anticipation loans, unsecured installment loans, and rent-to-own purchases—at high interest rates that were often marketed in a way to hide their true cost and prevent comparisons with other available options. Loans often included high-cost credit add-on products that often allowed lenders to shift costs to evade interest caps where they existed. Lenders were found to grant credit based on access to assets and income rather than ability to repay, and rely on roll overs or refinancing to trap borrowers in a cycle of debt. Products were marketed heavily to the military, through pervasive presence around military installations and the use of affinity marketing.

The 2006 Report documented pervasive, high interest lending targeting the military population and around military installations. For example, payday lenders, which charged annual percentage rates ranging from 390 to 780 percent, were significantly more likely to be located in areas adjacent to military installations than other areas of similar population. Internet lenders charged annual rates of 650 to 780 percent, exploited lack of federal regulations and inconsistent state laws to claim jurisdiction in states with no interest rate limits, and used tactics such as affinity marketing (e.g., advertising "military loans") to appeal to Service members. Vehicle title loans typically charged greater than 300 percent annually and were heavily concentrated around military installations.

The Department recommended several legislative actions. These included requiring unambiguous and uniform price disclosures; establishing a federal annual percentage rate limit for military borrowers of 36 percent; prohibiting lenders from offering credit without regard for ability to repay; prohibiting contract clauses that require Service members to waive special legal protections; requiring state laws to treat Service members stationed in a given state as citizens of that state with regard to state consumer protection laws. The Department recognized that, if adopted, these recommendations may have the result of limiting the availability of certain types of credit to Service members, but argued that such measures were necessary to ensure they resolve financial issues through more responsible means, such as available financial counseling or less costly financial products and prevent such harmful practices from undermining military readiness. The Department cautioned that an annual percentage rate limit should not be viewed as a target:

> Lenders should not interpret the 36 percent cap as a target for small loans provided to Service members; it would be a ceiling, and often a lower rate would be more appropriate to the risk of a borrower. The passage of such a protection should not be deemed an authorization for any lender to lend at a rate not otherwise authorized by applicable state or federal law.

Military Lending Act

In October 2006, Congress passed legislation in section 670 of the NDAA for FY 2007 (Public Law 109-364), commonly known as the MLA, which established certain terms of consumer credit and authorized the Secretary of Defense to prescribe regulations with an effective date of October 1, 2007. The MLA, codified at 10 U.S.C. § 987, applied to Service members on active duty, except for orders less than 30 days, and their dependents. The MLA included the following provisions:

(1) Establishes an annual percentage rate limit of 36 percent, to include all fees and charges, credit insurance, and other ancillary products sold with the extension of credit.
(2) Requires disclosures of annual percentage rate and payment obligations.
(3) Prohibits a lender from requiring a borrower to use a personal check, debit authorization, wage allotment, or vehicle title to secure credit.
(4) Requires states to apply state consumer protections to nonresident Service members and dependents residing within the state.
(5) Prohibits a lender from requiring arbitration, unreasonable legal notice provisions, or waiving rights under law including the Servicemembers' Civil Relief Act.
(6) Prohibits a lender from refinancing, renewing, or consolidating existing credit issued by the same lender.

The Secretary issued notice of proposed rulemaking and request for comment in April 2007 before publishing a final rule—32 CFR 232, "Limitations on Terms of Consumer Credit Extended to Service Members and Dependents"—in August 2007 (Federal Register Vol. 72, No. 169). Among other provisions, the MLA directed the Secretary to define "creditor" and "consumer credit" (i.e., to which products issued by which lenders the regulations would apply), as part of the implementing regulations. The Department narrowly defined "consumer credit" to three credit products it deemed most problematic: payday loans, vehicle title loans, and refund anticipation loans. It further defined each of these terms in part 232.2:

> "(i) *Payday loans*. Closed-end credit with a term of 91 days or fewer in which the amount financed does not exceed $2,000…"

> "(ii) *Vehicle title loans.* Closed-end credit with a term of 181 days or fewer that is secured by the title of a motor vehicle…"
>
> "(iii) *Tax refund anticipation loans.* Closed-end credit in which the covered borrower expressly grants the creditor the right to receive all or part of the borrower's income tax refund or expressly agrees to repay the loan with the proceeds of the borrower's refund."

The final rule defined the costs to be included when calculating the MAPR. Details of the MAPR are discussed later in this section.

Military Lending Act 2015 Regulations

In the NDAA for FY 2013 (Public Law 112-239), Congress enacted several amendments to the MLA effective in January 2013. These included allowing a covered borrower to recover damages for violations of the MLA's protections, modifying the definition of dependents for consistency with other military benefits, and requiring the Department to consult with certain identified federal regulatory agencies at least once every two years on the potential for necessary revisions to the law or its implementing regulations. The accompanying conference report, House Report 112-705, requested the Department to conduct analysis and submit a report on whether changes to the MLA regulations were necessary "to protect covered borrowers from continuing and evolving predatory lending practices…" In support of this analysis, the Department issued advanced notice of proposed rulemaking in the Federal Register on June 17, 2013 (Vol. 78, No. 116) to collect feedback from consumer advocacy groups, the financial industry, and other interested parties. Based on analysis of collected information, as well as internal surveys of Service members, financial counselors, and legal assistance attorneys, the Department submitted its report, "Enhancements of Protections on Consumer Credit for Members of the Armed Forces and Their Dependents," in April 2014. The report concluded that the narrow definition of consumer credit used in the original regulation no longer adequately addressed the current consumer marketplace, as lenders could slightly modify the terms of their products to avoid compliance, particularly the 36 percent MAPR.

The Department published a proposed rule on September 29, 2014 (Federal Register Vol. 79, No. 188) and a final rule on July 22, 2015 (Vol. 80, No. 140) to amend 32 CFR 232. The revised regulation modified the definition of "consumer credit" under subpart 232.3(f) to include "credit offered to a covered borrower for personal, family, or household purposes" that is either "subject to a finance charge" or "payable by a written agreement in more than four installments." This definition, consistent with the Truth in Lending Act, effectively extended the MLA to all forms of consumer credit other than specific exceptions made in the statute, namely residential mortgages and other mortgage-secured credit; credit "expressly intended" to finance a motor vehicle and secured by the motor vehicle being purchased; or credit "expressly intended" to finance other personal property and secured by the personal property being purchased.[1] While the revised regulation did not modify the MAPR limit of 36 percent as established in the MLA statute, it defined the calculation of the MAPR to account for the new types of credit products

[1] 32 CFR § 232.3(f)(2)

now covered by the regulation. The new regulations took effect on October 3, 2016, for all types of credit except credit cards, for which the new regulations took effect on October 3, 2017.

36 Percent Interest Rate Limit

The Department's 2006 Report recommended Congress pass a 36 percent annual percentage rate limit for credit extended to Service members and dependents. This number was not arbitrarily recommended by the Department, but had an academic, advocacy, and regulatory history dating from the early 20th century. The most prominent of these efforts was the Uniform Small Loan Law, drafted and promoted by the Russell Sage Foundation in response to the proliferation of illegal lending at interest rates that could exceed 1,000 percent. At that time, usury laws in many states placed a limit of six percent interest; legitimate lenders focused on profitable large loans, resulting in a black market for small loans. The 36 percent cap was seen as an exception to lower limits that allowed lenders to offer legitimate small loans that were profitable, while improving the consumer's ability to ultimately pay off the loan.

Between 1914 and 1943, 34 states adopted legislation inspired by the Uniform Small Loan Law, which generally placed a monthly limit of 3 to 3.5 percent, equivalent to 36 to 42 percent annually. Deregulation efforts in the 1970s and 1980s largely reversed these limits, though by the time of the Department's 2006 Report, several states had similar limits in place. In 2013, as the Department proposed updating its MLA regulations, 35 states had limits of 36 percent or less on small, installment loans made by nonbank lenders.[2]

Even where state laws existed, the military population presented a unique circumstance that was often unaddressed by state-imposed interest rate limits. In many cases, state enforcement of such limits did not extend to Service members stationed in, but not a resident of, that state (since the Servicemembers' Civil Relief Act allows Service members to maintain a state of legal residence even if military orders require them to relocate). As such, lenders could offer high-interest loans to Service members in circumvention of state law. Additionally, online lenders that targeted the military through tactics such as affinity marketing could claim jurisdiction in states with no limit. For example, the Department's 2006 Report found that all eight online installment lenders reviewed for the report claimed Nevada as their location, while all ten online payday lenders claimed to be based in Costa Rica or Delaware – all locations with no interest rate limit for consumer loans.

Military Annual Percentage Rate

Under the MLA, Congress directed the Secretary of Defense to prescribe regulations, consistent with the statute, to determine "the method of calculating the applicable annual percentage rate of interest…" The Department's 2015 regulation defines the current method for calculating the MAPR—the total of interest, fees, and other charges which may not exceed 36 percent of the total credit—in 32 CFR 232.4(c). These charges include:

(1) Premiums of fees for credit insurance, debt cancellation, or debt suspension products.

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[2] For more information on the history of the 36 percent interest rate cap, see the National Consumer Law Center's "Why 36%? The History, Use, and Purpose of the 36% Interest Rate Cap" (April 2013).

(2) Fees for credit-related ancillary products sold with the credit transaction.
(3) Finance charges as defined by the Consumer Financial Protection Bureau in 12 CFR 1026, known as "Regulation Z."
(4) Any application or participation fee, except an application fee charged by a federal credit union or insured depository institution for a short-term, small loan once in any 12 month period.

The regulation outlines specific exclusions for charges that would otherwise be included:

(1) A *bona fide* credit card fee that does not exceed the average amount of similar charges by large U.S. credit card issuers (see 32 CFR 232.4(d)).
(2) An application fee for a short-term, small loan made by a federal credit union or insured depository institution once in any 12-month period.

The Department defined the MAPR as such, in accordance with the MLA, to ensure lenders could not shift charges from interest to other fees in order to circumvent the limit.[3] Further, the Department expressed concern that credit-related products were sold without consideration for the benefits of military service, including insurance, job security, and disability benefits, that provide income security in the case of events covered by these products.[4] Some lender trade associations have recognized the uniqueness of the military population and rationale for this inclusion.[5]

Current Status

Since publication of the 2015 regulation, the Department has undertaken a number of additional efforts to understand the impact of the MLA and support financial industry compliance efforts. To aid compliance efforts, at the request of industry, the Department published an interpretive rule on August 16, 2016 (Vol. 81, No. 166), an amended interpretive rule on December 14, 2017 (Vol. 82, No. 239), and an interpretive rule on February 28, 2020 (Vol. 85, No. 40). These publications communicate DoD interpretations of a number of issues under the regulation.

Around the same time the Department published its 2015 regulation, Congress passed the NDAA for FY 2016 (Public Law 114-92), which included amending 10 U.S.C. 992. As amended, 10 U.S.C. 992 requires a comprehensive financial literacy program, to include training, counseling, and assessment. In 2019, DoD implemented financial readiness common military training requirements to help Service members develop the knowledge and skills necessary to address the financial considerations of personal and professional milestones throughout their military career. Training covers a variety of general and military-specific financial concepts, including the responsible use of credit, alternatives to high-cost credit products, consumer protections available under laws like the MLA, and how and where to report potential violations of

[3] Federal Register Vol. 80, No. 140, p. 43569 (July 22, 2015).
[4] Federal Register Vol. 80, No. 140, p. 43582 (July 22, 2015).
[5] Letter from the American Financial Services Association, Illinois Automobile Dealers Association, Illinois Financial Services Association, and the Independent Finance Association of Illinois, to Governor J.B. Pritzker on Senate Bill 1792 – the Predatory Loan Prevention Act (January 22, 2021): "Importantly, this distinction exists, in part, because certain types of insurance and protection products are available to members as a benefit of their military service."

consumer rights. Service members also have access to personal support through a network of more than 700 accredited financial counselors. In addition to helping Service members and families develop strategies to address financial goals and manage financial challenges, these professionals can help identify and report potential violations of consumer rights under the MLA, including referrals to installation legal assistance personnel and appropriate state and federal regulatory agencies.

The Department believes the MLA is currently working as intended and that Service members continue to have ample access to necessary credit. Survey results generally reflect decreased use of high-cost credit products and improved financial condition among Service members over time. Engagements with DoD financial educators and counselors indicate fewer seek assistance for financial challenges or debt resulting from high-cost credit products. Military aid societies, which provide financial assistance, similarly report fewer requests for assistance related to high-cost credit products. To date, the Department has no indication that Service members and their families lack adequate access to necessary, responsible credit. Regular consultation with federal regulatory agencies similarly indicates continued access to compliant credit products. The Department believes the full spectrum of tools, including supervisory examinations, are essential for effective industry education about, and compliance with, the MLA. These efforts should cover the full range of covered credit products and their providers. Monitoring and enforcement allows the Department and federal regulatory agencies to identify and respond to trends or early warning signs of harmful practices that can negatively impact the financial readiness of Service members. The Department regularly shares survey results and other findings with federal regulatory agencies to support their ongoing efforts to educate industry and promote compliance.

Overall, the MLA, in combination with the Department's ongoing financial literacy education and financial counseling efforts, appears to be effective in deterring unfair credit practices, ensuring Service members and families have continued access to affordable and responsible credit, and sustaining financial readiness in support of the Department's National Defense Strategy.

REDUCING THE MILITARY ANNUAL PERCENTAGE RATE

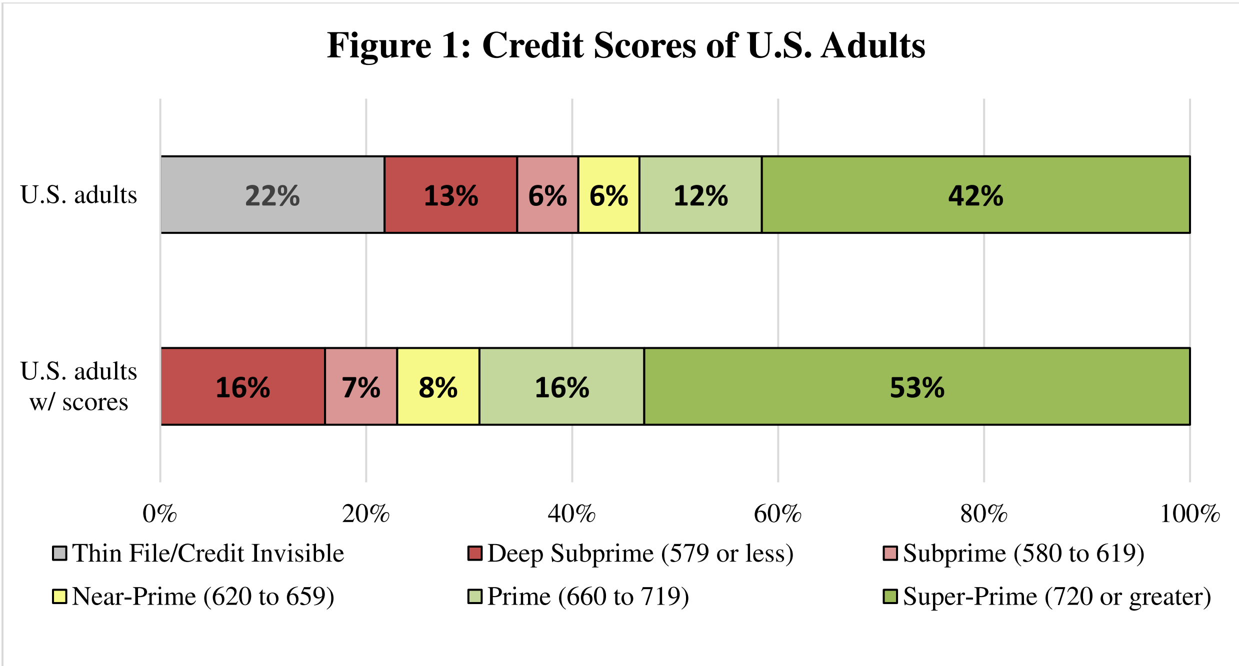
In order to analyze any impact on readiness and retention if Congress amended the MLA to lower the current maximum MAPR under 30 percent, the Department gathered various internal data sources, data from open sources, and observations from federal regulatory agencies to attempt to understand: 1) the credit risk of Service members, as measured by credit score; and 2) the status of the market for various credit products covered by the MLA. With this information, the Department sought to determine whether certain Service members would potentially lose access to various credit products if Congress lowered the existing annual percentage rate limited under the MLA. The Department takes no position on the merit of any change to lower the maximum MAPR rate under 30 percent.

The timeline for requested submission of this report did not allow for substantial new data collection strictly for this report. Instead, the Department relied on existing available data and believes this adequately reflects the current state of the military population and market for various credit products. However, the lack of transparent costs of certain financial products makes it difficult for the Department to assume how a certain interest rate or annual percentage rate may translate to the MAPR, which can include additional costs. This analysis reflects current and past market conditions; the Department cannot predict how future conditions may impact the cost of credit offered to Service members, including any long-term impact resulting from the COVID-19 pandemic. Additionally, this analysis is focused solely on a change to the MAPR limit and assumes all other provisions of the MLA statute and regulation remain unchanged. This includes excluding financial products such as payday loans and vehicle title loans that are effectively prohibited based on other provisions of the MLA, as well as those which are specifically exempt. To support this analysis, the Department consulted with federal regulatory agencies, including the Department of the Treasury as directed by the Committee.

The Secretary of Defense's existing authority under the MLA would further allow appropriate regulatory revisions to ensure Service members retain access to necessary consumer credit, such as amending the method for calculating the MAPR or considering appropriate exemptions to the definition of covered consumer credit.

Credit Risk of Service Members

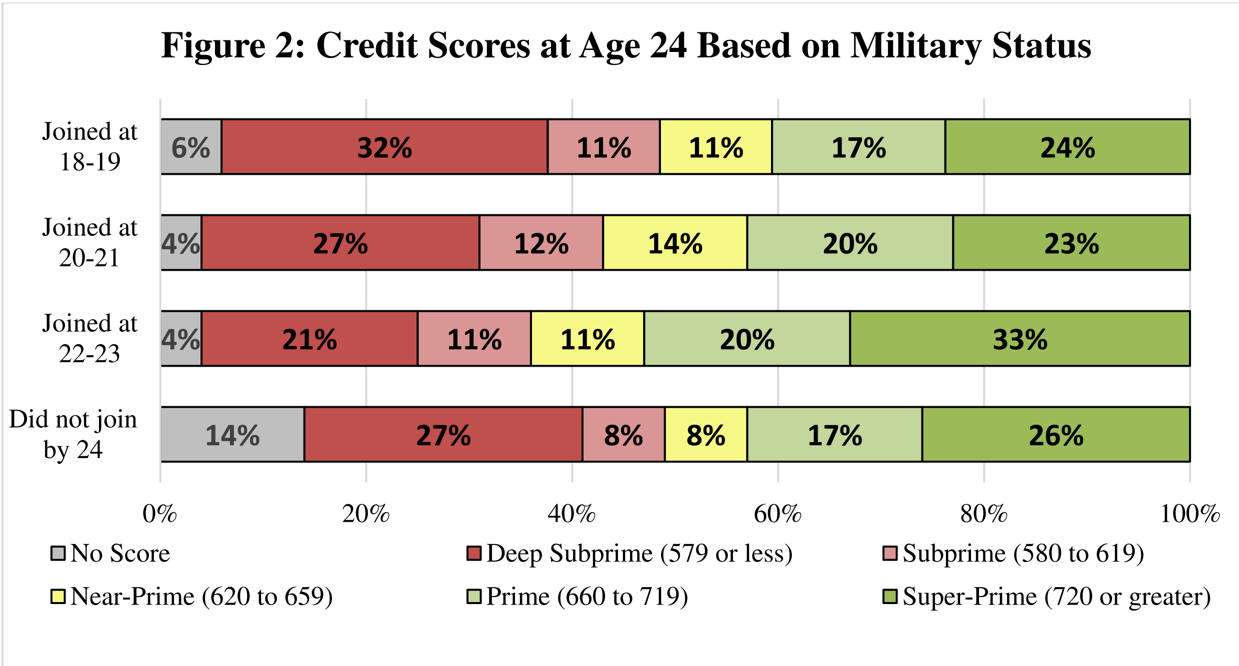
Figure 1 shows the distribution of credit scores for U.S. adults according to data from the Consumer Financial Protection Board's (CFPB) Consumer Credit Panel in Q4 2018.



Source: CFPB Consumer Credit Panel Q4 2018

The Department believes that Service members do not have significantly different credit scores than civilians across the entire population, and thus this data can be used to roughly reflect the credit score distribution of active duty Service members, absent an authoritative collection of credit scores that is representative of all active duty Service members. This conclusion is based on several data sources and observations. Most recently, a study by the CFPB observed the credit scores of nearly 300,000 individuals who turned age 18 between 2007 and 2010 until they turned age 24.[6] Figure 2 shows the credit scores of individuals in that population who served on active duty, based on age when they entered service, and those who had not by age 24. Those who served on active duty were more likely to have a credit score. Only those who joined at age 18 or 19 were more likely to have a deep subprime credit score than those who did not join. When accounting only for individuals who had credit scores, this difference was even smaller (34 percent to 31 percent).

[6] "Financially Fit? Comparing the credit records of young service members and civilians," Consumer Financial Protection Bureau (July 2020): The study notes that it did not consider thin file/credit invisible consumers and did not control for the demographics of active duty Service members (other than age), which differ from the comparison groups, in terms of race, education, marital status, and citizenship.



Source: "Financially Fit? Comparing the credit records of young servicemembers and civilians," CFPB (July 2020)

The same study looked closer at those who joined at age 18 or 19 and found that those who served at least 5 years had better average credit scores than civilians after the same time period, mitigating lower initial scores. The CFPB also found that young Service members who served shorter periods of time experienced the most severe drops in credit scores in the six months after service. These findings reflect that the credit scores of active duty Service members overall compare favorably to those of civilians, as only the youngest Service members who serve a short period of time exhibit lower scores than civilians.

In addition to these findings, several distinct aspects of military service may contribute to positive financial behaviors. For example, since credit behavior can impact a Service member's security clearance and ability to continue serving, they may be more likely to resolve negative credit behaviors or credit report issues. Individuals experiencing significant financial challenges may not enter service, either through self-selection or ineligibility to obtain a necessary clearance.

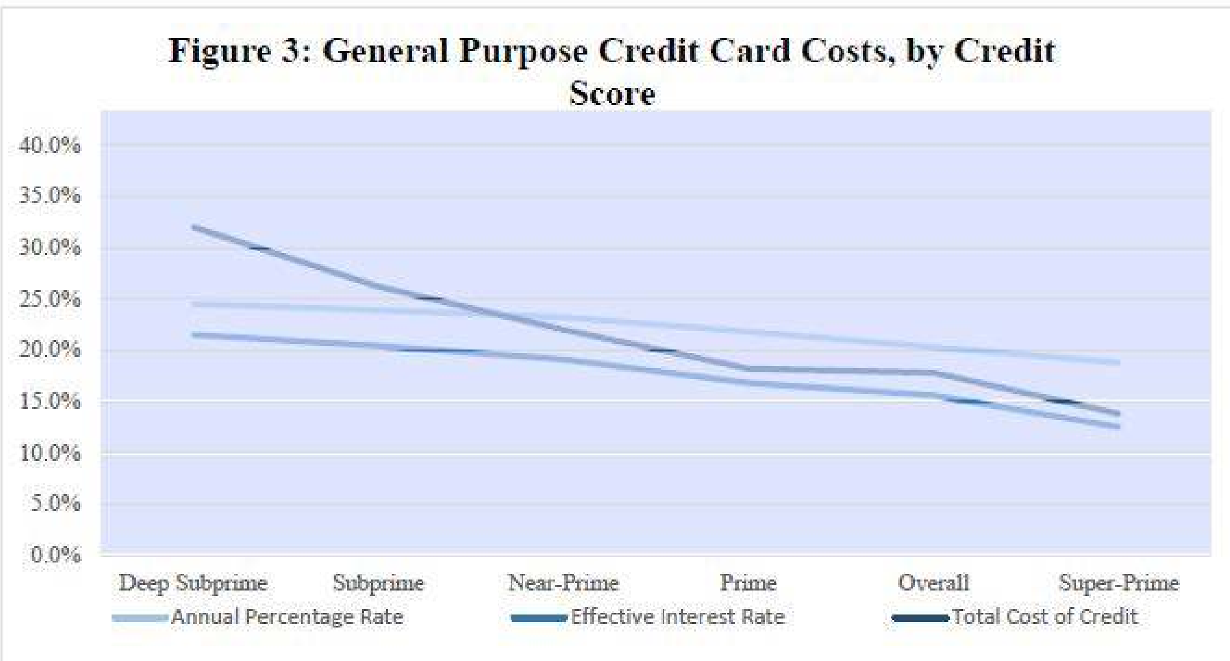
Credit Cards

The Department's 2015 regulation contains an exclusion from the MAPR for *bona fide* credit card fees, such as a cash advance or foreign transaction fee, which are reasonable when compared to similar fees charged by large credit card issuers. Like other credit products, the MAPR for credit cards generally includes finance charges and credit-related ancillary products.

The Board of Governors of the Federal Reserve System tracks the annual percentage rate of a number of common credit products. According to this data, in Q1 2020, the average rate for all credit cards offered was 15.09 percent, while the average for all credit cards that were assessed interest charges was 16.61 percent.[7] The CFPB reports more detailed data in its biennial report to Congress in accordance with the Credit Card Accountability Responsibility and Disclosure (CARD) Act, using data from its Consumer Credit Panel and the Federal Reserve's Y-14M data collection to report various measures of the cost of open-ended credit cards.

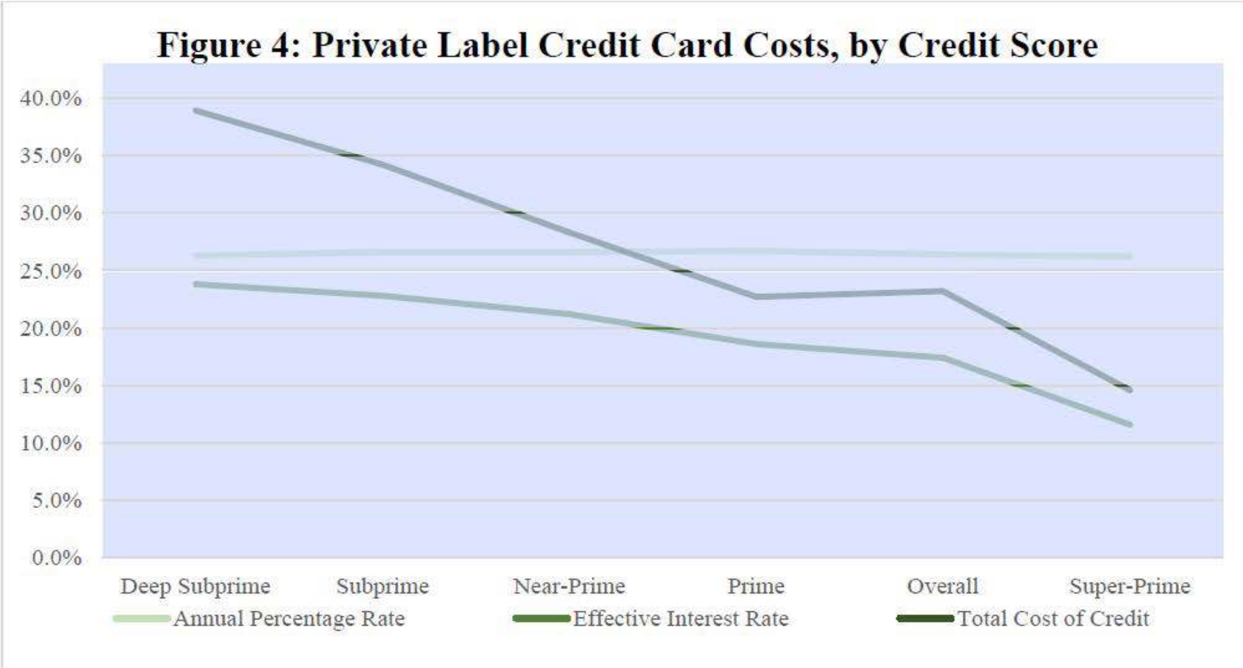
Three key measures used by the CFPB help understand these costs for general purpose and private label (store-issued) credit cards. The *annual percentage rate* is the advertised "retail" rate, which provides an indicator of how lenders price their products. The *effective interest rate* reflects the interest charges a borrower actually pays when accounting for carried balances and promotions. Finally, the *total cost of credit* accounts for total payments, to include interest and fees, and balances.

Figures 3 and 4 include these measures for general purpose and private label credit cards in 2018, respectively. As indicated, borrowers with higher credit scores had lower *effective interest rates* and *total cost of credit* than the *annual percentage rate*, reflecting the fact that these individuals are less likely to carry a credit card balance month-to-month and accrue interest charges.



Source: "The Consumer Credit Card Market," CFPB (August 2019)

[7] "Consumer Credit," Board of Governors of the Federal Reserve System (November 2020) https://www.federalreserve.gov/releases/g19/current/default.htm



Source: "The Consumer Credit Card Market," CFPB (August 2019)

While each of these measures is useful in some ways, it is not feasible to calculate an average MAPR because of the multitude of variables involved, e.g., whether fees are *bona fide* and thus exempt from the MAPR, whether the account has fees for credit add-on products that must be included in the MAPR, and the user's payment habits, which impact how finance charges are applied. The *annual cost of credit* reflects the advertised interest rate and would not account for all fees that must be included in the MAPR, while the *total cost of credit* would include fees that may be exempt from inclusion in the MAPR.

The *annual percentage rate* for general purpose credit cards ranged from 18.8 percent for users with super-prime credit scores to 24.5 percent for those with deep subprime credit scores. For private label cards, the average rate was approximately 26 percent regardless of credit score. The *total cost of credit* for general purpose credit cards ranged from 13.8 percent for users with super-prime credit scores to 32.2 percent for those with deep subprime credit scores. For private label cards, the average rate ranged from 14.6 percent for super-prime credit scores to 38.9 percent for deep subprime credit scores.

For those with subprime credit scores, a substantial portion of the *total cost of credit* was in fees. If credit card issuers generally price eligible, *bona fide* fees to be exempt from inclusion in the MAPR under 32 CFR § 232.4(d) and do not offer credit add-on products to covered borrowers (the Department argued that these products may not be appropriate for Service members), a MAPR limit of 28 percent would likely have no impact on a Service member's ability to obtain a credit card under similar market conditions to 2018, regardless of their credit score. If the MAPR was lowered to 25 percent, some general credit card issuers may choose to no longer offer credit cards to one-quarter of Service members (those with near-prime, subprime, and deep subprime credit scores) while others may amend their terms and conditions to comply with such a change. A limit of 26 percent may have similar impact on private label credit cards for all Service members.

It is also important to note that credit card usage varies by credit score at either end of the scale. While 16 percent of Americans with credit scores had deep subprime scores, they represented just 7 percent of those with credit cards. In contrast, 53 percent of those with scores had super-prime scores, while they made up 62 percent of those with credit cards. This difference may be due, in part, to the fact that those with the lowest credit cards chose not to use or are not able to access a credit card.

Personal Loans

Because the length and amount of a personal, or installment, loan can vary widely, and many states have laws and regulations on these loans, it can be difficult to generalize interest rates in the manner done elsewhere in this report. While the Federal Reserve reported an average interest rate on a 24 month loan of 9.63 percent in Q1 2020, this does not account for the loan amount which significantly impacts the interest rate.

According to analysis by the National Consumer Law Center (NCLC), several states and the District of Columbia currently limit various loans to an annual percentage rate under 30 percent: eight (AL, DC, HI, NC, ND, NY, PA, VT) for a six-month, $500 loan; ten (AR, CA, DC, MA, NY, OK, PA, RI, VT, WA) on a 24-month, $2,000 loan; and 27 states on a 60-month, $10,000 loan.[8] While these laws may apply narrowly to certain loan products, these are typically of the highest cost, such as payday loans and other small personal loans. Many Service members already benefit from these lower limits, since the MLA requires states to enforce their consumer laws for Service members located in that state, regardless of their residency status. For example, nearly a quarter of all active duty Service members in the United States are stationed in the 10 states that limit a 24-month, $2,000 loan to less than 30 percent.

In May 2020, the Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, National Credit Union Administration (NCUA), and the Office of the Comptroller of the Currency issued *Interagency Lending Principles for Offering Responsible Small-Dollar Loans*, encouraging financial institutions to "offer responsible small-dollar loans" consistent with core lending principles:

- Loan products are consistent with safe and sound banking, treat customers fairly, and comply with applicable laws and regulations.
- Financial institutions effectively manage the risks associated with the products they offer, including credit, operational, and compliance.
- Loan products are underwritten based on prudent policies and practices governing the amounts borrowed, frequency of borrowing, and repayment requirements.

Personal loans issued by federal credit unions are further subject to NCUA rules limiting the annual percentage rate to 18 percent, except for a specific exemption for payday alternative loans. Under the NCUA's payday alternative loan rule issued in 2019, federal credit unions that choose to participate may issue a loan up to $2,000 with a term of 1 to 12 months at an annual percentage rate of 28 percent. The rule allows only an application fee of no more than $20,

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[8] "Predatory Installment Lending in the States: 2020," National Consumer Law Center (February 2020) https://www.nclc.org/rpt-installmentloans-feb-2020

while the MLA allows such a fee to be excluded from calculation of the MAPR once per 12 month period. In addition, 2 of the 3 largest credit unions in the United States are traditionally military-focused, with nearly 400 branches across the country and overseas and more than 11 million members. A review of products and rates advertised by these credit unions in January and February 2021 found personal loans from $250 to $50,000 and $500 to $20,000, at rates up to 18 percent, or 28 percent for eligible payday alternative loans. As a result, large numbers of Service members and eligible dependents have access to credit products subject to rate limits lower than the existing MAPR limit.

The same review found that large banks that serve military populations also continue to offer personal loans under the MLA. One such bank with over 6 million accounts advertises loans from $2,500 to $20,000. Another with dozens of locations on military installations across the country advertises loans from $750 to $15,000, while the Department's contracted overseas banking provider with over 50 locations offers loans from $1,000. A bank with several locations on a large Army base advertises loans as low as $250. Other credit unions and banks advertise personal loans of various sizes at rates up to 36 percent, with many under 30 percent. While the Department's 2006 Report detailed the practices of online lenders that targeted the military population while charging interest rates in the triple figures, several such lenders have adjusted their practices to offer products that comply with the MLA, offering loans as low as $500 at up to 35.95%. Others chose not to modify their lending practices to comply and no longer serve the population covered by the MLA. The Department recognized this possibility in issuing its regulations, but believed limiting access to high-cost credit was necessary to protect the financial readiness of Service members and families.[9]

Impact on Readiness and Retention

While the MLA ensures Service members are not subject to unfair, predatory practices that can trap them in harmful cycles of debt, the Department recognizes the importance of education and counseling so Service members possess the knowledge and skills to make informed financial decisions on the appropriate use of credit while avoiding high-cost credit. Together, these efforts support Service members' ability to fulfill their financial obligations and maintain their financial readiness. To this end, DoD programs provide support throughout the military lifecycle in accordance with law and DoD policy. These efforts include providing financial readiness common military training in accordance with 10 U.S.C. § 992(a), and Directive-Type Memorandum 19-009, "*Financial Readiness Common Military Training Requirements,*" August 13, 2019, and other educational resources designed to reach Service members and their families through a variety of delivery methods. Service members also have access to financial counseling, as required by 10 U.S.C. § 992(b), through a network of more than 700 nationally-accredited financial counselors who provide factual, unbiased information to support Service members' ability to address their financial responsibilities. While education and counseling help them understand the importance of positive financial habits, such as having an emergency savings fund and using credit responsibly, most Service members will inevitably require access to some or all of the credit products described in this report. To date, the Department has no indication that Service members lack adequate access to such credit products. As this report has shown, credit cards, auto loans, and personal loans are widely available at risk-based rates under

[9] Federal Register Vol. 80, No. 140, p. 43565 (July 22, 2015)

the 36 percent MAPR. Even some online lenders that traditionally targeted the military population and charged exorbitant interest rates have modified their lending practices to comply with the MLA's cost of credit limit.

In December 2020 and January 2021, the CFPB settled enforcement actions against two lenders for violating terms of the MLA.[10] In January 2021, the CFPB further announced that it intends to resume supervision of lenders for compliance with the MLA.[11] Actions such as these, and continued supervision by other federal regulatory agencies, support readiness and retention by ensuring Service members have access to fair, responsible credit that complies with the MLA.

As previously stated, the Department takes no position on the merit of any change to lower the MAPR under 30 percent at this time, and sought only to identify any potential impact to readiness or retention if such a change were made.

Service members are expected to fulfill their financial obligations in accordance with DoD Instruction 1344.09, *"Indebtedness of Military Personnel,"* December 8, 2008, and exhibit responsible financial behaviors in order to maintain their security clearance. Failure to do so can distract both Service members and their superiors from mission requirements and result in loss of security clearance necessary to perform their assigned responsibilities, being deemed non-deployable, or administrative sanctions or prosecution potentially resulting in involuntary separation. While financial issues are a personal experience, an individual Service member's financial readiness has an associated impact on the ability of that member's unit to continue fulfilling their mission. In addition, data from the Department's annual Status of Forces Survey found that Service members who experienced a financial management challenge in the previous 12 months, were slightly more likely to indicate they were unlikely to remain on active duty, reflecting a potential relationship between personal finances and retention, as the Department has long maintained.

While credit cards are ideally used for convenience and paid in full monthly, the Department recognizes that Service members, like many others, may use credit cards to pay unexpected or additional expenses their monthly budget may not accommodate, carry a balance month-to-month, and may view a credit card as an essential component of their financial habits.[12] The analysis earlier in this report indicated that, assuming they generally price eligible *bona fide* fees

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[10] "Consumer Financial Protection Bureau Settles with Omni Financial of Nevada, Inc. for Violations of the Military Lending Act, Electronic Fund Transfer Act, and Consumer Financial Protection Act," Consumer Financial Protection Bureau (December 30, 2020) https://www.consumerfinance.gov/about-us/newsroom/consumer-financial-protection-bureau-settles-with-omni-financial-of-nevada-inc-for-violations-of-the-military-lending-act-electronic-fund-transfer-act-and-consumer-financial-protection-act/; "Consumer Financial Protection Bureau Settles with LendUp Loans, LLC for Military Lending Act Violations," Consumer Financial Protection Bureau (January 19, 2021) https://www.consumerfinance.gov/about-us/newsroom/consumer-financial-protection-bureau-settles-with-lendup-loans-llc-for-military-lending-act-violations/

[11] Dave Uejio, "The Bureau is taking much-needed action to protect consumers, particularly the most economically vulnerable," Consumer Financial Protection Bureau (January 28, 2021) https://www.consumerfinance.gov/about-us/blog/the-bureau-is-taking-much-needed-action-to-protect-consumers-particularly-the-most-economically-vulnerable/

[12] According to the Department's 2013 Quick Compass of Financial Issues survey, 20 percent of Service members indicated they would have difficulty managing their finances if they did not have access to a credit card, the highest among the credit products included on the survey.

to be exempt from inclusion in the MAPR, some general credit card issuers may choose to no longer offer credit cards to one-quarter of Service members (those with near-prime, subprime, and deep subprime credit scores) or may amend their terms and conditions to comply with a MAPR of 25 percent. A limit of 26 percent may have similar impact on private label credit cards for all Service members. A limit of 28 percent would likely have no impact on access to credit cards. However, it is difficult to assume the MAPR of any given credit card because of a number of variables, since the user's payment habits, advertised annual percentage rate, and optional and required fees all impact the ultimate calculation of the MAPR.

The consumer credit market has also changed dramatically, even in the years since the Department issued its 2015 regulation. For example, the emergence of point-of-sale consumer credit, also referred to as "buy now/pay later," allows consumers to split an online purchase over a scheduled number of payments, typically four or less, and often with no interest charge if paid on time. While overall usage is expected to triple to 4.5 percent of online payments between 2020 and 2024, buy now/pay later services are already used by roughly 20 percent of millennial consumers, which make up a large share of the military population. Usage may be even more pronounced among younger individuals who are less likely to use a credit card, either through choice or lack of access.[13] The Department found in its 2019 Status of Forces Survey that 27 percent of active duty junior enlisted Service members did not use credit cards, compared to 15 percent overall.

Small personal, or installment, loans typically have the highest costs of the credit products discussed in this report, though the Department has no indication that Service members lack access to these loans under the current rules. On the contrary, banks, credit unions, and online lenders, including many who traditionally serve the military population, advertise such loans as low as $250, $500, or $1000. Even several online "military loan" lenders that typically charged interest rates up to 700% have modified their practices to comply with the MLA, rather than exit the market.

Many lenders already offer such products at rates lower than 30 percent. Nearly a quarter of all active duty Service members in the United States are stationed in the ten states that limit a 24-month, $2,000 loan to less than 30 percent. Additionally, federal credit unions are limited to 28 percent interest on small loans under NCUA regulations, if they chose to offer such loans. The Department has no reason to believe similar terms applied to all covered borrowers under the MLA would negatively impact readiness. While Service members have access to small loans at reasonable costs under the current terms of the MLA, and the Department believes such access would continue under terms similar to the NCUA's payday alternative loan rules, they also have access to support from military aid societies. As the Department asserted in its 2015 regulation, these non-profit organizations provide grants or no-cost loans to help Service members address a variety of financial needs, such as emergency expenses, that in most cases can negate the need for a Service member to take out a small loan.

In its 2015 regulations, the Department stated that the MLA's benefit to retention was in restricting access to high-cost credit products, thus preventing Service members from becoming trapped in a harmful cycle of debt that leads to pervasive financial management challenges that

[13] Suzanne Kapner, "Macy's, Other Stores Let You Buy Now, Pay Later," *Wall Street Journal* (February 28, 2021).

could ultimately result in involuntary separation from the military. It estimated more than 7,500 annual involuntary separations where financial distress was a contributing factor.[14] There is no evidence to suggest an opposite effect: that retention would be negatively impacted simply because a certain credit product may no longer be available to a certain Service member. Regardless, the Department is interested in ensuring Service members have continued access to credit products and believed it developed the 2015 regulations in a way that allowed creditors to continue offering products such as credit cards and personal loans by making reasonable changes to the terms and conditions.[15] The Department would need to conduct further analysis and seek additional input before revising regulations to implement any change to the MAPR, to ensure Service members and families retain access to necessary sources of credit.

As the analysis in this report has shown, a MAPR limit as low as 28 percent would likely have no impact on Service members' access to credit cards, assuming credit card issuers meet exemptions for eligible *bona fide* fees when calculating the MAPR. The same limit of 28 percent on small-dollar personal loans would bring these products in line with existing rules governing federal credit unions, where such products continue to be widely-available. Assuming limits consistent with these findings, the Department would anticipate no negative impact to readiness or retention, even if some creditors choose to no longer offer credit to borrowers covered by the MLA.

[14] Federal Register Vol. 80, No. 140, p. 43600 (July 22, 2015).
[15] Federal Register Vol. 80, No. 140, pp. 43573, 43585 (July 22, 2015).

CONCLUSION

Congress has been a valuable partner in protecting Service members and families from predatory lending practices by passing the MLA in 2007 and amending it in 2013. The Department believes the MLA, under current regulations issued in 2015, is working as intended. The MLA and MAPR support Service members and families by ensuring they are not subject to unfair credit practices that can negatively impact financial readiness and, in turn, military readiness. The MAPR places a reasonable limit, with a long regulatory history, on the cost of credit that prevents covered borrowers from becoming trapped in a harmful cycle of debt resulting from egregious interest rates.

In issuing its 2015 regulations, the Department recognized that some lenders may choose to no longer offer some of the now-broader scope of credit products to covered borrowers, while others may amend their terms and conditions to apply. Nevertheless, the Department believed such a step was necessary to protect Service members and their families and that they would still have adequate access to credit. Several years after the implementation of those regulations, these borrowers continue to enjoy access to compliant credit products to meet their needs. They also have access to no-cost loans or grants from military aid societies that can address a number of financial needs. The Department also appreciates the efforts of the federal regulatory agencies to educate about, supervise, and, when necessary, enforce, the MLA, in particular the renewed efforts of the CFPB to include MLA compliance in on-going supervision of lenders under its oversight.

While the Department takes no position on the merit of lowering the MAPR limit at this time, it is committed to continue working with Congress to support the financial readiness of Service members and their families and is willing to provide comment on any such proposal when appropriate.