

New Rule Limits ‘Predatory’ Loans to Servicemembers

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WASHINGTON, Sept. 28, 2007 – The Defense Department is instituting new protections that will help defend servicemembers against high-interest emergency loans that can lead to a dangerous cycle of debt. A new regulation included in the 2007 National Defense Authorization Act limits the annual percentage rate on payday loans, vehicle title loans and tax refund anticipation loans to 36 percent for active-duty servicemembers and their families. The change takes effect Oct. 1.

This is a big change, as the interest rates on these “predatory” loans can run as high as several hundred percent, said David S.C. Chu, undersecretary of defense for personnel and readiness. Troops and their families have often fallen victim to these loans when they come up short between paychecks, and they can lead to serious problems, he said.

“It’s a big problem for commanders, because what happens is often these households get themselves in over their heads,” Chu said. “They’re \$200 short between now and next payday, but they’re no better off when payday comes, so they need a bigger loan, and it just goes downhill from there.”

The 36 percent limit in the regulation includes all fees and charges, and the rule prohibits contracts requiring the use of a check or access to a bank account, mandatory arbitration and unreasonable legal notice, Chu said. The regulation makes it a criminal offense for lenders to knowingly charge a higher interest rate to servicemembers, so it is essential that military members be honest about their status when applying for loans, he said.

“One of the things that we’re a little worried about is people may be tempted, in order to get this old product that is now off limits, to answer this question in a non-factual way,” Chu said. “They need to be honest.”

It is the states’ responsibility to enforce the regulation, Chu said, and already 27 states have stepped forward and agreed to enforce restrictions on the financial institutions. The department has received the assurance of federal regulators that they will oversee the institutions they regulate, he said.

In addition to implementing this new regulation, the Defense Department also is stepping up efforts to educate servicemembers about financial planning and where to go for help in an emergency, Chu said. Many times, servicemembers can go to their bank or credit

union directly and ask what loan products they have available, he said, or they can go to their military aid societies or the family community support centers.

In addition, most institutions that troops would owe money to, including the Internal Revenue Service, often are willing to work with clients to defer payments. Servicemembers also can go to the online resources Military OneSource and Military Homefront for information on financial planning.

“The first defense here ... is good education for our people so they understand better how to manage their finances wisely, so they don’t get themselves in trouble and so they don’t come up short at the end of the month or the end of the pay period,” Chu said. “But if they do, they know where to turn and how to get help.”

This regulation is important because financial readiness directly affects mission readiness for military members, Chu said. If a troop is worried about an unpaid credit card bill, a needed car repair, or any other financial crisis, he won’t be able to focus on the mission. Chu said commanding officers from around the military have applauded the Defense Department’s efforts in this arena, because individual financial problems often cause unit readiness problems.

“As commanders, even at the division level, they are dealing with the fallout among their people from these kinds of payday loans,” Chu said. “They want to get this problem off the screen; they want to solve the problem too. I think we have a whole community that’s ready to move forward.”

The Federal Deposit Insurance Corporation, which guarantees deposits by commercial banks, has agreed to work with the Defense Department on this regulation, because it is a chance to promote emergency small loans for servicemembers, as well as other citizens in the United States, Chu said.

“We are perhaps at the leading edge of a national movement, trying to put better financial management on everyone’s screen, military and civilian, and of course ultimately, that is the goal -- that our people are better equipped to deal with financial issues,” he said.

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