

April 2005

# MILITARY PERSONNEL

## DOD's Tools for Curbing the Use and Effects of Predatory Lending Not Fully Utilized



G A O

Accountability \* Integrity \* Reliability



Highlights of [GAO-05-349](#), a report to Senator Richard J. Durbin

## Why GAO Did This Study

The Department of Defense (DOD) has expressed concerns about servicemembers' use of predatory consumer loans as well as their overall financial conditions. "Predatory lending" has no precise definition but describes cases where a lender takes unfair advantage of a borrower, sometimes through deception, fraud, or terms such as very high interest or fees. Serious financial problems can adversely affect unit morale and readiness as well as servicemembers' credit history and military career. DOD has tools such as off-limits lists to help curb the use and effects of predatory loans.

GAO answered two questions: (1) To what extent do active duty servicemembers use consumer loans considered to be predatory in nature? and (2) Are DOD and active duty servicemembers fully utilizing the tools that DOD has to curb the use and effects of predatory lending practices?

## What GAO Recommends

GAO is making two recommendations for DOD to curb the use and effects of predatory lending practices on servicemembers: amend regulations to require at least semi-annual meetings of the Armed Forces Disciplinary Control Boards and clarify regulations pertaining to advertisements in official DOD publications. DOD concurred with GAO's recommendations.

[www.gao.gov/cgi-bin/getrpt?GAO-05-349](http://www.gao.gov/cgi-bin/getrpt?GAO-05-349).

To view the full product, including the scope and methodology, click on the link above. For more information, contact Derek Stewart at (202) 512-5559 or [stewartd@gao.gov](mailto:stewartd@gao.gov).

## MILITARY PERSONNEL

# DOD's Tools for Curbing the Use and Effects of Predatory Lending Not Fully Utilized

## What GAO Found

The extent to which active duty servicemembers use consumer loans considered to be predatory and the effects of that borrowing are unknown. The only DOD-wide data come from surveys. In a 2004 survey, 12 percent of servicemembers said they or their spouse had used, during the last 12 months, at least one of four types of loans: payday, rent-to-own, automobile title pawn, or tax refund, which DOD says can often be associated with predatory lending practices. DOD is unable to quantify the extent to which the loans have associated predatory practices, the frequency of such borrowing, the amounts borrowed, or the effects of the loans. Although not generalizable, participants in GAO's 60 focus groups at 13 bases in the United States and Germany identified problems resulting from the use of short-term consumer loans, but other participants described the loans as quick, easy, and obtainable by servicemembers with bad credit. Privacy concerns and the reluctance of servicemembers to reveal financial problems make it difficult to quantify the use and effects of predatory lending.

DOD and active duty servicemembers are not fully utilizing DOD's tools for curbing the use and effects of predatory lending practices. At some of the installations that we visited, the Armed Forces Disciplinary Control Board—a panel that can recommend to an installation commander that a business be placed off-limits to servicemembers—had not met in over a year. Fort Drum's board, for example, had not met in about 4 years, even though the New York Attorney General had filed two lending-related lawsuits against businesses on behalf of servicemembers and some of their family members at Fort Drum. DOD officials told us the reasons for boards not meeting or making recommendations include high deployment levels and the effort required to place a business on an off-limits list. Other commanders effectively changed businesses' predatory practices by using their board's recommendations to place or threaten to place the businesses off-limits. In addition, DOD is not always providing a clear message regarding advertising in installation publications. Participants in GAO's focus groups said they were confused because DOD-provided financial management training (described in our 2005 report, *Military Personnel: More DOD Actions Needed to Address Servicemembers' Personal Financial Management Issues*) warned them against using payday lenders but some installation newspapers carried advertisements for such businesses. These problems occur even though a DOD instruction requires (1) a disclaimer indicating that the advertisement does not constitute endorsement by the U.S. government and (2) a review by public affairs staff to determine if the advertisement might be detrimental to servicemembers. Our review of some installation newspapers showed possible reasons for the confusion; the disclaimers were often not prominently displayed or were located away from the advertisements. DOD also offers servicemembers free legal review of contracts and other financial transactions, but servicemembers often do not use the reviews until problems result. Recently, DOD began exploring additional on-installation alternatives to payday loans.

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### Abbreviations

DOD	Department of Defense
PFM	personal financial management

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United States Government Accountability Office  
Washington, D.C. 20548

April 26, 2005

The Honorable Richard J. Durbin  
United States Senate

Dear Senator Durbin:

The Department of Defense (DOD) has expressed continuing concerns about servicemembers' use of predatory consumer loans. These loans can result in financial problems that may lead to severe negative consequences for the military as a whole (e.g., decreases in unit readiness and morale) as well as for the servicemembers themselves (e.g., criminal and adverse personnel actions, including possible discharge from the military). "Predatory lending" has no precise definition, but is generally used to describe cases in which a lender takes unfair advantage of a borrower, sometimes through deception, fraud, or manipulation, to make a loan that contains terms that are disadvantageous to the borrower.<sup>1</sup> DOD policy officials have expressed concerns over certain types of high-cost, short-term consumer loans that are typically provided by lenders who lie outside the system of federally insured financial institutions. These include payday loans, rent-to-own loans, automobile title pawn loans, and tax refund loans.

DOD has a number of tools to address the use and effects of loans that it considers predatory. These tools include: (1) the Armed Forces Disciplinary Control Boards,<sup>2</sup> which can make recommendations to installation commanders who can then use or threaten to use their "off-limits" authority to prohibit servicemembers from using a business that engages in predatory lending practices; (2) free legal assistance with

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<sup>1</sup>See GAO, *Consumer Protection: Federal and State Agencies Face Challenges in Combating Predatory Lending*, [GAO-04-280](#) (Washington, D.C.: Jan. 30, 2004). The cited report addresses home mortgage lending and equity loans, but our work did not. Nevertheless, some lending practices are widely acknowledged to be predatory and include charging excessive fees and interest rates, repeatedly rolling over or refinancing loans without economic gain for the borrower, falsifying documents, and intentionally misinforming borrowers about the terms of their loans.

<sup>2</sup>For the joint service instruction, see AR190-2, OPNAVIST1620.2A, AFI31-213, MCO1620.2C, COMDTINST1620.1D, *Armed Forces Disciplinary Control Boards and Off-Installations Liaison and Operations* (June 1993). Under this joint policy, installation commanders, at their discretion, may establish such boards to advise and make recommendations to the commanders on matters concerning eliminating conditions around their installations that are adversely affecting the health, safety, welfare, morale, and discipline of the Armed Forces.

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contracts and other financial transactions; and (3) personal financial management (PFM) programs that offer servicemembers assistance, such as financial management training and counseling. In addition, DOD has encouraged servicemembers to seek, for example, payday loan alternatives available from on-installation banks, on-installation credit unions, and service-affiliated relief/aid societies.<sup>3</sup>

This report supplements the information we provided to you in our February 2004 report on bankruptcies among active duty servicemembers, and our April 2005 report on the financial conditions of deployed servicemembers and the financial management assistance and training provided to servicemembers.<sup>4</sup> For this report, we agreed with your staff to answer two questions: (1) To what extent do active duty servicemembers use consumer loans considered to be predatory in nature? and (2) Are DOD and active duty servicemembers fully utilizing the tools that DOD has to curb the use and effects of predatory lending practices?

In addressing these two questions, we limited the scope of our work to active duty personnel and emphasized junior enlisted servicemembers (i.e., pay grades E1 to E4) because DOD and service officials have indicated that this subgroup—whose basic pay currently ranges from about \$1,200 to \$1,900 per month—is most likely to encounter financial problems. Numerous methods were used to gather and assess information for this work.<sup>5</sup> We examined DOD and service policies and tools for assisting servicemembers with their financial management, establishing and using Armed Forces Disciplinary Control Boards, and advertising in installation publications. In addition, we reviewed reports by GAO, other congressional research offices, DOD, and other organizations. We contacted the Federal Trade Commission to ascertain what data were available through Military Sentinel regarding the types of consumer complaints servicemembers filed against businesses. We interviewed DOD and service policy officials and officials from organizations such as the Consumer Federation of America—

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<sup>3</sup>See GAO, *Military Personnel: More DOD Actions Needed to Address Servicemembers' Personal Financial Management Issues*, [GAO-05-348](#) (Washington, D.C.: Apr. 26, 2005) for information about the military's PFM training and counseling, as well as other components of the PFM programs. These programs are part of DOD's core family support programs that are used to address the adverse effects associated with personal financial problems.

<sup>4</sup>See [GAO-05-348](#) and GAO, *Military Personnel: Bankruptcy Filings among Active Duty Service Members*, [GAO-04-465R](#) (Washington, D.C.: Feb. 27, 2004).

<sup>5</sup>The data for this work were gathered at the same time as the data used in [GAO-05-348](#).

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a consumer advocacy group—and the Community Financial Services Association of America—a payday lending association—to understand the different perspectives about servicemembers’ use of short-term consumer loans. During site visits to 13 military installations in the United States and Germany, we requested documents pertaining to predatory lending such as guidance or instructions regarding predatory lending activities at the installations and training materials; used structured questionnaires to gather data from a variety of personnel on the 13 installations: command leaders, PFM program managers, command financial counselors, legal assistance attorneys, senior noncommissioned officers (pay grades E8 to E9), chaplains, and staff from the military relief/aid societies; and conducted 60 focus groups composed of over 400 junior (pay grades E1 to E4) and senior (pay grades E5 to E9) enlisted servicemembers, company grade officers (pay grade O1 to O3), and servicemembers’ spouses. In addition, we administered a questionnaire to participants in the focus groups to collect supplemental information. While data from these four types of homogeneously composed focus groups are not generalizable to the entire DOD population of active duty servicemembers, the data provide context for understanding lending/borrowing and PFM issues. In addition, we conducted group interviews of personnel affiliated with the PFM programs while they attended a November 2004 conference. We reviewed 14 installation newspapers and examined the disclaimers and advertisements in these newspapers during the course of our review. We reviewed information in DOD’s August 2004 active duty survey related to findings for four types of loans: payday, rent-to-own, automobile title pawn, and tax refund, which DOD says may include predatory practices. The August 2004 survey had a response rate of 40 percent. DOD has conducted and reported on research to assess the impact of this response rate on overall estimates. They found that, among other characteristics, junior enlisted personnel (E1 to E4), servicemembers who do not have a college degree, and members in services other than the Air Force were more likely to be nonrespondents. We found the data sufficiently reliable to address our objectives. We performed our work from March 2004 through February 2005 in accordance with generally accepted government auditing standards.

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## Results in Brief

The extent to which active duty servicemembers use consumer loans considered to be predatory in nature and the effects of such borrowing are unknown, but many sources suggest that providers of such loans may be targeting servicemembers. The only DOD-wide data come from surveys that have low response rates that make findings projected to the population

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of all active duty servicemembers or subgroups thereof tenuous. In a 2004 survey, 12 percent of servicemembers said they or their spouse had used, during the last 12 months, at least one of four types of loans: payday, rent-to-own, automobile title pawn, and tax return, which DOD says can often be associated with predatory lending practices. DOD is unable to quantify the extent to which the loans have associated predatory practices, the frequency of borrowing, the amounts borrowed, or the effects of the loans. Although not generalizable, participants in GAO's 60 focus groups at 13 bases in the United States and Germany identified problems such as high fees and debt collection methods resulting from the use of these types of short-term consumer loans, but other participants described the loans as quick, easy, and obtainable by servicemembers with bad credit. Privacy concerns and the reluctance of servicemembers to reveal financial problems make it difficult to quantify the use and effects of predatory lending. While DOD is unable to quantify usage and effects, consumer advocates, state government officials, DOD officials, and servicemembers in our focus groups indicated that military personnel are being targeted by some predatory lenders and are adversely affected when they use businesses that employ predatory lending practices.

DOD and active duty servicemembers are not fully utilizing DOD's tools for curbing the use and effects of predatory lending practices. While commanders at some installations we visited have changed the illegal or unfair practices of some businesses by using recommendations from Armed Forces Disciplinary Control Boards to place or threaten to place businesses off-limits to servicemembers, boards at three installations we visited had not met in over a year. For example, Fort Drum's board had not met in about 4 years, even though the New York Attorney General had filed two lending-related lawsuits against businesses on behalf of servicemembers and some of their family members at Fort Drum. Installation officials told us the reasons for boards not meeting or making recommendations include high deployment levels and the effort required to place a business on the off-limits list. A second tool that DOD is underutilizing pertains to advertisements in installations' newspapers. Participants in GAO's focus groups said they were confused because DOD-provided financial management training warned them against using payday lenders but some installation newspapers carried advertisements for such businesses. These problems occur even though a DOD instruction requires (1) a disclaimer indicating that the advertisement does not constitute endorsement by the U.S. government and (2) a review by public affairs staff to determine if the advertisement might be detrimental to servicemembers. Our review of some installation newspapers showed that the confusion and



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incorrect assumptions may be, in part, the result of the disclaimers often being located away from the advertisement or not being prominently displayed. Third, servicemembers typically have not made full use of free DOD-provided legal assistance before signing contracts and other financial documents, but they sometimes use the assistance after financial problems develop. According to servicemembers and legal assistance attorneys, military personnel may avoid the DOD-provided legal assistance for fear that their career progression would be limited if the command were to learn of their financial problems. Recently, DOD has explored additional on-installation alternatives to payday loans, like special loan programs offered by on-installation credit unions and banks.

We are making two recommendations to improve DOD's ability to curb the use and effects of predatory lending practices: (1) amend existing regulations to require at least semiannual meetings of the Armed Forces Disciplinary Control Boards and (2) clarify regulations pertaining to advertisements in installation publications to require more prominent disclaimers and additional steps to ensure advertisements reflect stated DOD policies. In commenting on a draft of this report, DOD concurred with our recommendations.

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## Background

DOD officials have expressed concern that servicemembers are often the victims of predatory lending practices by certain types of lenders who typically lie outside the system of traditional financial institutions such as banks. These lenders offer alternative access to cash for consumers with low incomes or poor credit records, and generally do so without standard credit checks. The fees charged for these alternative loans are generally much higher than those charged by traditional financial institutions, and other terms and conditions of such loans are often unfavorable to the borrower. As a result, some federal, state, and consumer advocacy agencies have expressed concern that many of these alternative loans could include predatory practices. The most common of these loans include the following:

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- *Payday loans*, according to the Federal Deposit Insurance Corporation, are small, short-term loans that borrowers promise to repay out of their next paycheck or deposit of funds. These loans typically have high fees and are often rolled over repeatedly, which can make the cost of borrowing—expressed as an annual percentage rate—extremely high.<sup>6</sup>
  - *Rent-to-own loans*, according to the Federal Trade Commission, provide immediate access to household goods (such as furniture and appliances) for a relatively low weekly or monthly payment, typically without any down payment or credit check. Consumers have the option of purchasing the goods by continuing to pay “rent” for a specified period of time—however; the effective cost of the goods may be two to three times the retail price.<sup>7</sup>
  - *Automobile title pawns* provide short-term loans to borrowers who give the lender the title to their car as collateral for the loan. Effective interest rates are generally very high.
  - *Tax refund loans* provide cash loans against the borrower’s expected income tax refund.

Senior DOD and service officials have noted that such loans may have associated predatory lending practices, which can be detrimental to servicemembers who choose these loans as a way to overcome immediate needs for cash. The fees for loans such as the payday loans provide a general indication of the loans’ potential detrimental financial effects on servicemembers’ finances. The Community Financial Services Association of America, a payday-advance trade association, which says that it represents more than half of the payday advance industry, developed a set of best practices for its member companies. Among other things, the association’s best practices limit the number of extensions for outstanding

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<sup>6</sup>According to the Federal Reserve Bank of Philadelphia, fees for a payday loan range from \$15 to \$30 on each \$100 advanced. If the fee is \$15 to borrow \$100 for 14 days, the annualized percentage rate for that loan is 391 percent. If the borrower extends the 14-day loan four times beyond the initial loan, the 70-day loan of \$100 would result in paying \$75 in fees in addition to repaying the borrowed \$100.

<sup>7</sup>*Survey of Rent-to-Own Customers*, Federal Trade Commission Bureau of Economics Staff Report (undated).

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advances.<sup>8</sup> Association representatives noted that borrowers select payday loans over other alternatives for a number of reasons. For example, in some instances, the officials stated that the individual may not have the good credit history required to borrow from a bank or credit union. In other instances, an individual might use a payday loan to avoid a bounced check fee, late payment penalty, or reconnection fees associated with the late payment of a utility bill. The Congressional Research Service estimated that the number of payday loan offices nationwide increased from approximately 300 in 1992 to almost 15,000 in 2002, and the total dollar volume of payday loans in 2002 was about \$25 billion.<sup>9</sup>

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## Use of Consumer Loans That Are Considered Predatory Is Unknown, but Sources Say Predatory Lenders May Be Targeting Servicemembers

The extent to which active duty servicemembers use consumer loans considered to be predatory and the effects of such borrowing are unknown, but many sources suggest that predatory lenders may be targeting servicemembers. While DOD has some data on servicemembers' use of four types of loans, DOD is unable to quantify the extent to which these types of loans have associated predatory practices, the frequency of borrowing, the amounts borrowed, or the effects of the loans. Information from our focus groups, however, provided insights to some of these issues. Although DOD is unable to quantify usage and effects, consumer advocates, state government officials, DOD officials, and servicemembers in our focus groups indicated that military personnel are being targeted by some predatory lenders.

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<sup>8</sup>The association's Web site ([www.cfsa.net](http://www.cfsa.net)) states that "a member will comply with State laws on rollovers (the extension of an outstanding advance by payment of only a fee). In States where rollovers are not specifically allowed, a member will not under any circumstances allow a customer to do a rollover. In the few States where rollovers are permitted, a member will limit rollovers to four (4) or the State limit, whichever is less." The association also established a separate set of best practices for dealing with military customers and published them on its Web site.

<sup>9</sup>See Congressional Research Service, *Payday Loans: Federal Regulatory Initiatives*, RS21728 (Washington, D.C.: Feb. 5, 2004).

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## DOD Has Limited Data for Quantifying the Extent That Servicemembers Use Consumer Loans Considered Predatory

DOD does not have comprehensive data for quantifying the extent to which servicemembers use consumer loans that are considered predatory in nature and the effects of such use on servicemembers' finances or their units' readiness. The only DOD-wide statistics on servicemembers' use of loans are obtained from surveys. In the August 2004 DOD survey,<sup>10</sup> 12 percent of servicemembers indicated that, during the last 12 months, they or their spouse had used at least one of the four specified types of financial loans that DOD says may have associated predatory practices. Seven percent of servicemembers indicated they (or their spouse) had obtained payday loans; 4 percent had obtained rent-to-own loans, 1 percent had obtained automobile title pawn loans, and 6 percent had obtained tax refund loans. While only 2 percent of the officers had used any of the four financial transactions, 14 percent of the junior and 13 percent of the senior enlisted servicemembers had used at least one such loan. Although not generalizable to all active duty servicemembers and their spouses, some of the more than 400 participants in our 60 focus groups reported encountering problems when they used the short-term consumer loans; while other servicemembers said such loans have positive elements such as being quick, easy, and obtainable even if servicemembers had a bad credit history (see app. II for example comments).

DOD's efforts to assess predatory lending are hampered by the lack of a precise definition of predatory lending—a problem shared with other organizations attempting to quantify the use and effects of predatory loans. The lack of precision in the definition is found in DOD's acknowledgement that the four types of loans may (i.e., not always) contain predatory lending practices, but other DOD statements state that payday lending is predatory, without including a qualifier. Imprecision in the definition and the way the questions are asked on surveys can affect results. For example, the percentage of servicemembers who reported using the various types of loans may be larger than the percentage of servicemembers who would have said they obtained a predatory loan, had the question been oriented somewhat differently. Other important issues not addressed in the survey but needed to quantify the extent and effects of borrowing from lenders

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<sup>10</sup>Because the response rate for this survey was 40 percent, uncertainty exists as to how well the survey findings actually project to the population of all active duty servicemembers or any subgroup thereof. The loan-related items presented in this report are only a small portion of the many and diverse questions on the survey. According to DOD, the sampling errors for all of the following estimates from the August 2004 survey do not exceed plus or minus 2 percentage points.

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that may use predatory lending practices include questions on the frequency of use, amounts borrowed, negative and positive effects of the loans, and any problems encountered during the transactions.

DOD, service, and installation officials maintained that obtaining data on the use and effects of predatory lending are also hampered because of privacy considerations and the reluctance of most servicemembers to discuss their financial difficulties with their command. Installation officials told us that they are likely to learn about servicemembers' use of the previously cited types of loans only when a situation has become serious enough to warrant creditors contacting the command or servicemembers contacting either financial counselors or legal assistance attorneys on the installations. Because of general privacy concerns, it is unlikely that all contacts with attorneys and counselors could be provided in an installation-level statistic.

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### Multiple Sources Indicate Some Predatory Lenders May Be Targeting Servicemembers

According to some consumer advocates, state officials, DOD officials, and military personnel, servicemembers are targeted by predatory lenders. A 2003 National Consumer Law Center report stated that junior enlisted servicemembers are targeted because they have a relatively low but secure income (with military basic pay that currently ranges from about \$1,200 to \$1,900 per month) and tend to be young and financially inexperienced.<sup>11</sup> The report further suggested that deploying servicemembers are more vulnerable targets than their nondeploying peers because the former often must get their finances in order quickly and leave behind spouses who may not know how to manage the family's finances. The report noted several financial practices that it considered "consumer scams" aimed at servicemembers. These included payday loans, rent-to-own transactions, and automobile title pawns.

Some state officials have also suggested that payday lenders—a type of predatory lending according to DOD—target servicemembers. For example, the Georgia General Assembly has recently determined as part of its new antipayday lending legislation that despite its illegality, payday lending was growing in Georgia and having an adverse effect on

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<sup>11</sup>See National Consumer Law Center, Inc., *In Harm's Way—At Home: Consumer Scams and the Direct Targeting of America's Military and Veterans* (Boston, Mass.: May 2003).

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servicemembers and others in the state.<sup>12</sup> Similarly, the Florida governor's 2004 statement to the Committee on Senate Armed Services, Subcommittee on Personnel, noted that Florida had regulated activities of payday loan and check cashing businesses that traditionally target servicemembers. In 2004, the Under Secretary of Defense for Personnel and Readiness posted an issue paper on its Web site<sup>13</sup> to the National Governors Association that addressed payday lending and other personnel issues. Regarding payday lending, the Under Secretary stated that "Payday lending practices have proven to be detrimental to servicemembers who have chosen these loans as a way of overcoming immediate needs for cash...Statutes that cap small loan interest rates and establish usury ceilings help protect vulnerable servicemembers from the usury nature of payday loans and their associated predatory practices."

According to a 2004 Consumer Federation of America study, 15 states prohibit or limit payday lending through laws on interest rate caps for small loans, usury laws, or specific prohibitions for check cashers.<sup>14</sup> We did not independently verify that these 15 states, in fact, do prohibit this activity, nor did we review laws in the other 35 states. Figure 1 shows these 15 states identified by the Consumer Federation of America, along with information on the number of active duty servicemembers on installations in each state. Even in those states that prohibit or otherwise regulate payday loans, servicemembers may be able to obtain such loans. Another Consumer Federation of America report noted that a growing number of Web sites deliver small loans, with some lenders using anonymous domain registrations or residing outside the United States.<sup>15</sup>

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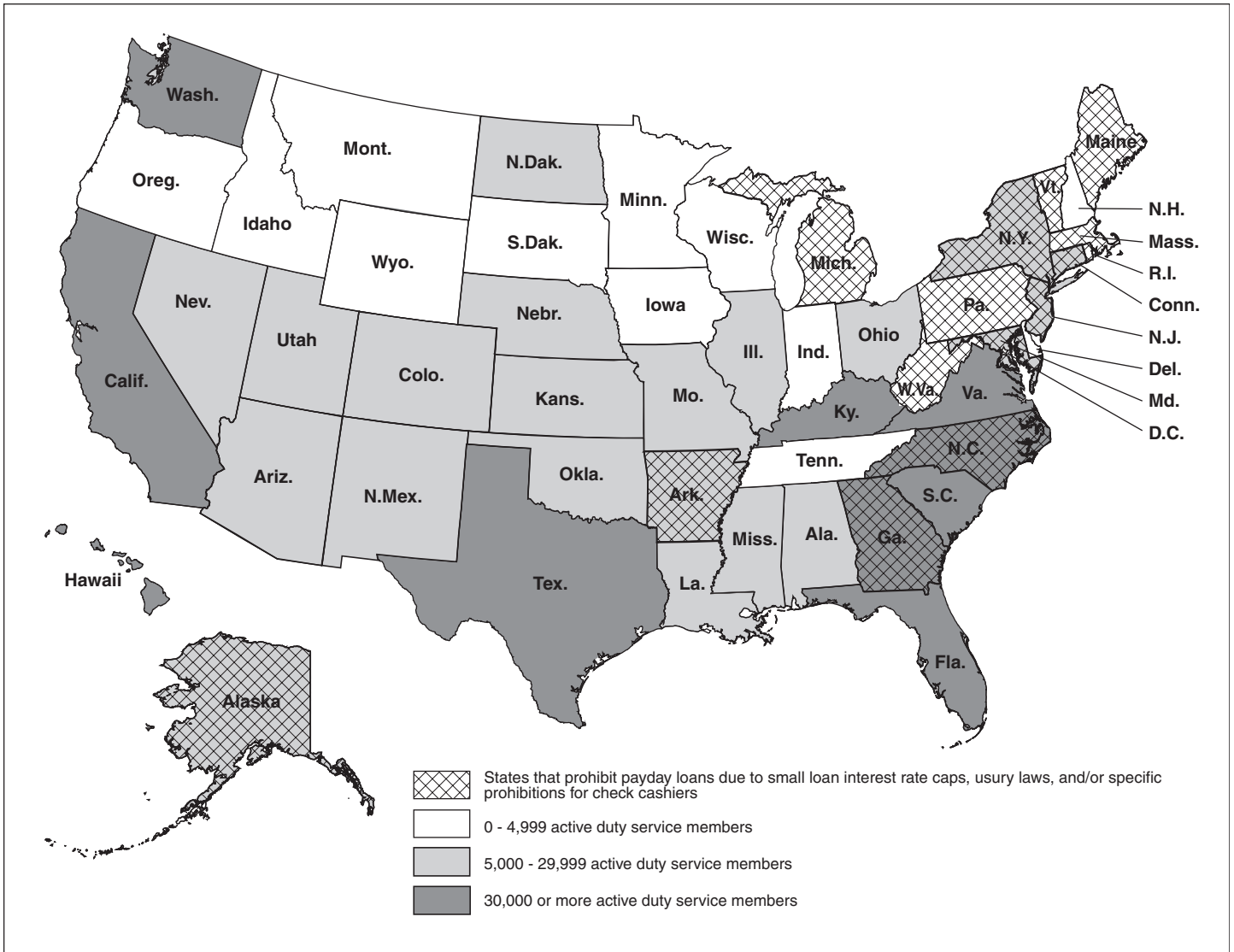
<sup>12</sup>Official Code of Georgia Annotated Title 16, Chapter 17.

<sup>13</sup>See DOD Web site <http://www.USA4MilitaryFamilies.org>.

<sup>14</sup> See Consumer Federation of America, *Unsafe and Unsound: Payday Lenders Hide Behind FDIC Bank Charters to Peddle Usury* (Washington, D.C.: Mar. 30, 2004). This report noted that 33 states and the District of Columbia authorize payday loans by law or regulation, and two additional states have no usury limits on small loans by licensed lenders.

<sup>15</sup>See Consumer Federation of America, *Internet Payday Lending: How High-Priced Lenders Use the Internet to Mire Borrowers in Debt and Evade State Consumer Protections* (Washington, D.C.: Nov. 30, 2004).

**Figure 1: The Number of Servicemembers in Each State and Whether or Not the State Has Payday Lending Laws with Interest Caps or Other Prohibitions**



Source: Department of Defense and Consumer Federation of America.

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## DOD's Tools for Curbing the Use and Effects of Predatory Lending Underutilized

DOD and servicemembers are underutilizing the tools that DOD has for curbing predatory lending practices and the effects of such lending. While commanders at some installations we visited have changed the unfair practices of businesses by using recommendations from Armed Forces Disciplinary Control Boards to place or threaten to place businesses on off-limits lists to servicemembers, boards at other installations we visited rarely met or made such recommendations. Although installation newspapers appear to meet current disclaimer requirements by including a statement noting that the U.S. government does not endorse a business' products or services, the advertisements may lead to confusion for readers because the disclaimers are not prominently printed or located near the advertisement. Additionally, servicemembers typically have not made full use of free DOD-provided legal assistance before signing contracts and other financial documents, but they sometimes use the assistance after financial problems develop. Recently, DOD has sought to expand the tools available for curbing the use and effects of predatory lending practices by exploring additional on-installation alternatives to payday loans.

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## Armed Forces Disciplinary Control Boards Can Be an Effective Tool for Curbing Predatory Lending Practices, but They Are Underutilized

Armed Forces Disciplinary Control Boards and the recommendations that they make to an installation commander to place businesses off-limits to servicemembers can be effective tools for avoiding or correcting unfair practices, but data gathered during some of our site visits to the various installations revealed few times when boards were used to address predatory lending practices.<sup>16</sup> For example, at three of the installations, the board had not met for more than a year and, therefore, may not have adequately addressed whether actions were needed against businesses

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<sup>16</sup>Under current DOD joint policy, if a board concludes that an establishment has unfair commercial or consumer practices, the installation commander can prohibit servicemembers from frequenting the business by placing the entity on an off-limits list. There are several steps a board completes prior to making a recommendation to the commander to place an establishment on the off-limits list. These steps include (1) notifying the owner or manager that the board is considering actions, and giving the owner or manager time to correct any adverse conditions or practices; (2) if the adverse conditions are not corrected, giving the owner or manager the opportunity to appear and present matters before the board; and (3) recommending an off-limits restriction, if further investigation indicates that improvements have not been made. These steps, according to some installation officials, can be time consuming and are designed to permit the owner or manager to voluntarily correct conditions or practices before the board recommends placement on an off-limits list. If a commander places a business on the off-limits list, servicemembers are prohibited from entering the establishment and face disciplinary action if they violate this prohibition.



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whose practices negatively affected servicemembers. The board at Fort Bragg, North Carolina, had not met for over a year and the board at Fort Stewart, Georgia, had not met since 2003 because the Directors for both boards had deployed to Iraq. The board at Fort Drum, New York, had not met in about 4 years because the board's Director did not see a reason to convene. He was not aware of two recent, lending-related lawsuits filed by the New York Attorney General that had connections with Fort Drum servicemembers.

- The Attorney General settled a lawsuit in 2004 in behalf of 177 plaintiffs—most of whom were Fort Drum servicemembers—involving a furniture store that had improperly garnished wages pursuant to unlawful agreements it had required customers to sign at the time of purchase.
- The Attorney General filed a lawsuit in 2004 involving catalog sales stores. He characterized the stores as payday-lending firms that charged excessive interest rates on loans disguised as payments toward catalog purchases. Some of the servicemembers and family members at Fort Drum fell prey to this practice. The Attorney General stated that he found it particularly troubling that two of the catalog stores were located near the Fort Drum gate.

The Garrison Commander at Fort Drum and a representative of the board said that had they known about these cases, they would have considered placing the businesses on the off-limits list. Legal assistance attorneys at Fort Drum were, however, aware of the legal actions by the New York Attorney General. By not making full use of the boards, commanders may not be doing all they can to help servicemembers avoid businesses that employ predatory practices.

According to officials at the installations we visited, the boards might not be used as a tool for dealing with predatory lenders for a variety of reasons. First, high deployment levels have resulted in commanders minimizing some administrative duties, such as convening the boards, in order to use their personnel for other purposes. Second, as long as the lenders operate within state laws, the boards may determine they have little basis to recommend placing or threatening to place businesses on the off-limits lists. Third, significant effort may be required to put businesses on off-limits lists. At the installations we visited, the boards' composition included representatives from functional areas like public works, family community services, legal counsel, safety, and public affairs.

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In contrast, businesses near two other installations we visited changed their lending practices after boards recommended that commanders place or threaten to place businesses on off-limits lists. The Commander of the Navy Region Southwest's board identified actions that were based on the board's recommendations against businesses committing illegal acts or taking unfair advantage of servicemembers. For example, in October 2002, a company was placed off-limits because it represented itself as a government agency when arranging loan-repayment allotments with servicemembers, threatened debtors with court-martial for nonpayment, and wrote loans that had interest rates of 60 percent. Similarly, the board at Camp Lejeune, North Carolina, threatened to take action against a lender that was charging 33.1 percent interest and requiring servicemembers to waive their rights set forth by the Servicemembers Civil Relief Act.<sup>17</sup> The business avoided being placed on the installation's off-limits list by terminating two employees and changing some of its business practices.

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### Advertising in Installation Newspapers Could Confuse Servicemembers about Whether the Military Endorses Payday Lenders

In some instances, DOD is not providing a clear message about whether it endorses advertisers in official installation newspapers. Some servicemembers in our focus groups said they were confused about whether the military endorses the businesses that advertise in installation newspapers, and the confusion could lead servicemembers to use a type of business that DOD has labeled as potentially having predatory lending practices. Earlier, a 2003 Army publication stated that payday loan advertisements appear in official and unofficial military publications, and readers often incorrectly assume that military officials have approved the businesses and their claims.<sup>18</sup> A DOD instruction requires installation publications to run disclaimers warning readers that advertisements do not constitute endorsement by the U.S. government. The instruction also requires public affairs staffs to oversee the appropriateness of advertisements in installation publications.<sup>19</sup> Among other things, the public affairs staff is to review advertisements and identify any that may be

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<sup>17</sup>50 U.S.C. App. § 501. The act, among other things, caps the annual interest at 6 percent on debts incurred prior to a person's entry into active duty military service and sets forth procedures for requesting such a reduction.

<sup>18</sup>See "Consumer Scams: Are You Getting Ripped Off?" *Hot Topics*, Vol. 5, No. 4 (2003). U.S. Army publication by the Office of the Chief of Public Affairs.

<sup>19</sup>DOD Instruction 5120.4, Enclosure 4, Department of Defense *Newspapers, Magazines and Civilian Enterprise Publications* (June 16, 1997).

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detrimental to DOD personnel or their family members. If an advertisement is found to be detrimental, the public affairs staff is to take steps to either have the advertisement removed by the publisher or report the situation to the installation commander who can act to preclude distribution of the publication on the installation.

Servicemembers' confusion about businesses' advertisements may have multiple causes. First, readers may not see the advertising disclaimer. We reviewed 14 installation newspapers and found that all of them contained a disclaimer; however, we also observed that the disclaimers were typically (1) included only once in the newspaper, (2) listed with other administrative notices such as statements identifying the publisher and the availability of advertised items, and (3) located remotely from many of the advertisements. Second, advertisements for some types of businesses may run contrary to official DOD statements about the use of those businesses. Servicemembers participating in our focus groups said they were confused because DOD officials and information provided during PFM training warned against using payday lenders but such lenders were allowed to advertise in installation newspapers. We observed two such advertisements for a payday lender during our review of the 14 installation newspapers, and PFM program managers wrote comments about this issue when responding to a GAO survey of all PFM managers. Third, there is confusion about which businesses do and do not use predatory lending practices. For example, the PFM program manager at one installation identified a particular car financing business as predatory, but the PFM program manager at another installation sometimes directs servicemembers to this same business when they have had past credit problems that limit their loan options. Fourth, legal assistance attorneys on some of the installations we visited told us that lenders and other businesses are free to advertise in the newspapers. A potential negative effect of the confusion regarding whether businesses are approved and endorsed by the installation is that servicemembers may use types of businesses that DOD policy officials have determined to be predatory, rather than seeking assistance through alternatives such as military relief/aid societies identified by the installation PFM program manager and staff.

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### Servicemembers Do Not Make Full Use of Free DOD-Provided Legal Assistance for Financial Issues

Servicemembers do not take full advantage of free DOD-provided legal assistance on contracts and other financial documents. Legal assistance attorneys at the 13 installations we visited stated that servicemembers rarely seek their assistance before entering into financial contracts for goods or services such as purchasing cars or lifetime film developing.

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The attorneys said that servicemembers are more likely to seek their assistance after encountering problems such as the following selected examples:

- Used car dealers offered low interest rates for financing a vehicle, but the contract stated that the interest rate could be converted to a higher rate later if the lender did not approve the loan. Servicemembers were later called to sign a new contract with a higher rate. By that time, some servicemembers found it difficult to terminate the transaction because their trade-in vehicles had been sold.
- Used car dealers refused to allow servicemembers to take their contracts to a legal assistance attorney for review. In one such instance, a servicemember signed a contract to pay \$30,000 for a car with a blue book value of \$12,000.
- A company used car titles as collateral on loans and required servicemembers to provide an extra set of keys to the cars so that they could be easily repossessed if the loans were not paid. This type of transaction can result in triple-digit interest.

During our interviews, legal assistance attorneys said they provide preventive briefings to incoming and deploying servicemembers to address financial issues such as car buying, payday loans, and debt management during deployment. In some cases, they might take actions to assist servicemembers who have financial problems. Depending on the circumstances, they may represent servicemembers in local court involving consumer cases that affect the military community. In addition, while most legal assistance attorneys do not represent servicemembers in bankruptcy cases, they may provide servicemembers with information on bankruptcy, advice about whether filing is appropriate, and a reference to an off-installation civilian attorney.

Legal assistance attorneys, as well as other personnel in our interviews and focus groups, noted reasons why servicemembers might not take greater advantage of the free legal assistance before entering into business agreements. They stated that junior enlisted servicemembers who want their purchases or loans immediately may not take the time to visit the attorney's office for such a review. Additionally, the legal assistance attorneys noted that servicemembers feared information would get back to the command about their financial problem and limit their career progression.

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## DOD Is Exploring On-Installation Alternatives to Payday Loans

DOD, service, and installation officials are exploring on-installation alternatives to payday loans for those servicemembers with financial problems. In 2004, DOD said it surveyed approximately 150 defense credit unions and received responses from 48. Of those responding, which may not be representative of all defense credit unions due to the low response rate, 29 credit unions said that they offer an alternative to payday lending. The alternatives, which can be shared with other on-installation credit unions and banks as well as PFM program managers and command financial counselors, included (1) low-cost, short-term lines of credit; (2) short-term signature loans or small unsecured signature loans; and (3) availability of funds 2 days before the servicemember's normal pay date.

Some of the PFM program managers at the 13 installations we visited had also worked with on-installation credit unions and banks to obtain payday loan alternatives, which included special loan programs or overdraft protection of up to \$500 for customers with "less-than perfect" credit histories. One credit union that we visited advertised a loan alternative called QuickCash, which had an annual percentage rate of 18 percent. To use QuickCash, servicemembers were required to join the credit union, apply for the loan, and have the repayment deducted from their account the following pay period. Some of the on-installation credit unions also offer seminars and training to assist servicemembers in finding lending alternatives.

Other alternatives to payday loans include pay advances and military relief/aid society grants and no interest loans to servicemembers.<sup>20</sup> Some servicemembers in our focus groups stated that they would not use these types of installation-related alternatives because the alternatives take too long, are intrusive because the financial institution or relief/aid society required in-depth financial information in the loan or grant application, or may be career limiting if the command found out the servicemembers were having financial problems. The Army Emergency Relief Society has attempted to address the time and intrusiveness concerns with its test program, Commander's Referral, for active duty soldiers lacking funds to

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<sup>20</sup>These are provided during emergencies, which include nonreceipt or loss of pay, funeral expenses for dependents, repair of a primary vehicle, and payment of rent to prevent eviction. See AR-930-4, *Army Emergency Relief* (Aug. 30, 1994) section 2-11 (Categories of authorized emergency financial assistance); and Air Force Instruction 36-3109, *Air Force Aid Society* (Mar. 5, 2004). The Navy and Marine Corps Relief Society officials said they do not have an instruction.

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meet monthly obligations of \$500 or less. After the commander approves the loans, the servicemembers can expect to receive funds quickly. Noncommissioned officers in our individual interviews and focus groups said the program still does not address servicemembers' fears that revealing financial problems to the command can jeopardize their careers.

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## Conclusions

Although we have cited examples where installation commanders changed the predatory practices of businesses by adding or threatening to add the lenders to an off-limits list, other installation commanders we visited have made only limited use of their Armed Forces Disciplinary Control Board for such purposes. The fact that some boards have not met for a year or more seems to run contrary to DOD, service, and installation efforts to curb the use and effects of predatory lending practices. As we have discussed, failure to utilize this valuable tool fully and appropriately for curbing unfair or illegal commercial or consumer practices can have negative, but difficult-to-quantify, consequences on servicemembers' finances as well as unit morale and readiness. Furthermore, although military installations appear to be meeting current requirements regarding disclaimers for advertisements in installation publications, the location of the disclaimer has resulted in unclear messages to some servicemembers about whether inclusion of certain advertisements constitutes approval or endorsement of the business by DOD. In addition, some servicemembers have been confused when the content of some advertisements is contrary to official DOD statements regarding the use of lenders who may use predatory lending practices. This confusion is particularly problematic because it may harm DOD's efforts to reduce the use and effects of predatory lending practices.

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## Recommendations for Executive Action

We are making the following two recommendations to the Secretary of Defense:

- To improve DOD's ability to curb the use and effects of predatory lending practices, we recommend that the Secretary of Defense direct the Under Secretary of Defense for Personnel and Readiness to amend existing regulations to require installation commanders to convene the Armed Forces Disciplinary Control Boards at least semiannually to investigate and make recommendations to commanders on matters related to eliminating conditions which adversely affect the health, safety, morals, welfare, morale, and discipline of the Armed Forces, to

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include servicemembers' use of lenders who may use predatory lending practices.

- To ensure DOD provides servicemembers a clear message about whether it endorses advertisers in official installation newspapers that may use predatory lending practices, we recommend that the Secretary of Defense direct the Assistant Secretary of Defense for Public Affairs to clarify the regulations pertaining to advertisements in installation publications by requiring disclaimers to be more prominent and taking steps to ensure advertisements reflect stated DOD policies regarding what it considers to be predatory lending.

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## Agency Comments and Our Evaluation

In written comments on a draft of this report, DOD concurred with our recommendation to clarify regulations pertaining to advertisements in installation publications and partially concurred with our recommendation to amend regulations to require at least semiannual meetings of the Armed Forces Disciplinary Control Boards.

In its comments, DOD noted that it is in the initial stages of staffing and coordinating changes to the Armed Forces Disciplinary Control Boards' joint regulations and will take two actions—require boards to meet four (instead of two) times a year and direct that businesses on the off-limits list for one service be off-limits for all services. Although DOD's comments dealt primarily with the issue of payday lending, the intent of our recommendation was to address all types of consumer predatory lending encountered by servicemembers. Moreover, DOD's actions will go even further than our recommendation suggested. DOD also noted that the boards' process would be an ineffectual deterrent against payday lenders for several reasons. For example, it stated that the boards' process would be ineffectual because of the difficulty in providing adequate oversight of all payday lending businesses and noted that installation commanders may have to develop criteria outside of state statutes for the 35 states where payday lending is legal. Our draft report had already noted that boards may have little basis for recommending or threatening to place businesses on an off-limits list when lenders operate within state laws. Our recommendation will (1) require the boards to meet regularly and (2) provide installation commanders additional focus and oversight into conditions that may adversely affect servicemembers on their installations. Implementing our recommendation does not require installation commanders to monitor all payday lending businesses; instead, it is intended to provide commanders with a routine process for reviewing and taking appropriate action against

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those lenders that adversely affect servicemembers on the commanders' installation.

DOD's comments are reprinted in appendix III. DOD also provided technical comments, which we incorporated in the final report as appropriate.

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As agreed with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days after its issue date. At that time we will send copies of the report to the Secretary of Defense and interested congressional committees. We will also make copies available to others upon request. This report will be available at no charge on GAO's Web site at <http://www.gao.gov>.

If you or your staff have any questions regarding this report, please contact me at (202) 512-5559 ([stewartd@gao.gov](mailto:stewartd@gao.gov)) or Jack E. Edwards at (202) 512-8246 ([edwardsj@gao.gov](mailto:edwardsj@gao.gov)). Other staff members who made key contributions to this report are listed in appendix IV.

Sincerely yours,

A handwritten signature in black ink that reads "Derek B. Stewart". The signature is written in a cursive style with a large initial 'D'.

Derek B. Stewart  
Director, Defense Capabilities and Management



# Scope and Methodology

In addressing the objectives of this engagement on predatory lending, we limited our scope to active duty servicemembers because we have previously issued a number of reports on the compensation, benefits, and pay-related problems of reservists.<sup>1</sup> While performing our work, we visited 13 installations with high deployment levels, as identified by service officials (see table 1).<sup>2</sup> During these site visits to installations in the United States and Germany, special emphasis was given to ascertaining the financial conditions of junior enlisted servicemembers because the Department of Defense (DOD) and service officials have reported that this subgroup is more likely to encounter financial problems.

**Table 1: Installations in the United States and Germany Where GAO Conducted Site Visits from May to October 2004**

Service	Installation
Army	Fort Bragg, North Carolina
	Fort Campbell, Kentucky
	Fort Drum, New York
	Fort Lewis, Washington
	Fort Stewart, Georgia
Navy	Ray Barracks, Friedberg, Germany
	Naval Air Station Jacksonville, Florida
Marine Corps	Naval Station San Diego, California
	Camp Lejeune, North Carolina
Air Force	Camp Pendleton, California
	Bolling Air Force Base, Washington, D.C.
	Langley Air Force Base, Virginia
	Ramstein Air Base, Germany

Source: GAO.

To address servicemembers use of consumer loans considered to be predatory in nature, we reviewed and analyzed laws, policies, and

<sup>1</sup>Our work focused on active duty servicemembers. The Related GAO Products section at the end of this report lists several products that focus on reservists and their compensation, benefits, and pay-related problems that result from deployment.

<sup>2</sup>To facilitate efficient data collection, the data for this engagement were gathered at the same time as those used to prepare [GAO-05-348](#).

directives—such as the Servicemembers Civil Relief Act<sup>3</sup> and DOD’s Financial Management Regulation 7000.14R, Volume 7A. We also reviewed and analyzed lending-related findings and perspectives contained in publications issued by GAO, DOD, Congressional Research Service, Federal Reserve Bank of Philadelphia, Federal Deposit Insurance Corporation, Federal Trade Commission, state government officials, consumer groups (Consumer Federation of America and National Consumer Law Center), and an association that says it represents around 50 percent of payday lenders (Community Financial Services Association of America). We reviewed a 2004 Consumer Federation of America study, which cited 15 states that prohibit or limit payday lending through laws on interest rate caps for small loans, usury laws, or specific prohibitions for check cashers.<sup>4</sup> We did not independently verify that these 15 states, in fact, do prohibit this activity, nor did we review laws in the other 35 states. We also contacted the Federal Trade Commission and ascertained that its Military Sentinel database has little information on servicemembers’ complaints against businesses. We interviewed DOD and service policy officials, as well as representatives of consumer groups and a payday association. During our 13 site visits, we developed and used structured questionnaires for interviews with seven types of officials: installation leaders, personal financial management (PFM) program managers, command financial counselors, senior noncommissioned officers (pay grades E8 to E9), legal assistance attorneys, chaplains, and relief/aid societies. We used a structured protocol for conducting 60 focus groups with over 400 individuals who met in four homogeneous types of groups: junior enlisted servicemembers (pay grades E1 to E4), noncommissioned officers (pay grades E5 to E9), company-grade officers (pay grades O1 to O3), and spouses of servicemembers. In addition, we constructed, pretested, and administered a survey to participants in the focus groups to collect supplemental information that may have been difficult to collect in a group setting. We also obtained data from an August 2004 DOD-wide survey<sup>5</sup> to assess its reliability and determine prevalence rates for four types of loans that DOD says may contain predatory practices. The August

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<sup>3</sup>50 U.S.C. App. § 501.

<sup>4</sup>See Consumer Federation of America, *Unsafe and Unsound: Payday Lenders Hide Behind FDIC Bank Charters to Peddle Usury* (Washington, D.C.: Mar. 30, 2004).

<sup>5</sup>The target population for all active duty Status of Forces Surveys consists of active duty members of the Army, Navy, Marine Corps, and Air Force, excluding National Guard and Reserve members who (1) have at least 6 months of service at the time the questionnaire is first fielded, and are (2) below flag rank.

2004 survey had a response rate of 40 percent. DOD has conducted and reported on research to assess the impact of this response rate on overall estimates. They found that, among other characteristics, junior enlisted personnel (E1 to E4), servicemembers who do not have a college degree, and members in services other than the Air Force were more likely to be nonrespondents. We have no reason to believe that potential non-response bias in the estimates, not otherwise accounted for by DOD's research, is substantial for the variables we studied in this report. Therefore, we concluded the data to be sufficiently reliable to address our objectives. We found the data sufficiently reliable to address our objectives. This information was supplemented with information obtained from three group discussions with a total of 50 personnel affiliated with the PFM programs while they attended a November 2004 conference.

To assess whether DOD was fully utilizing the tools that it has to curb the use and effects of predatory lending practices, we obtained information from the laws, policies, directives, and reports that were used to address servicemembers' use of loans that DOD considered to be predatory in nature. DOD and service policy officials identified DOD's primary tools for curbing the use and effects of predatory loans. These individuals also supplied their perspectives on how fully utilized those tools were. Similarly, individual interviews and focus groups with others who supplied information on the question related to servicemembers' use of consumer loans also provided their perspectives on how fully the tools were used, the effects of underutilizing the tools, and possible reasons that some tools were not used more fully. In addition, we examined official installation newspapers to determine whether they contained disclaimers and advertisements for loans that DOD officials say may contain predatory practices. This examination of newspapers was just a cursory review and was not based on any sort of random sampling. Interviews with representatives of on-installation credit unions and national military relief/aid societies provided input about alternatives to payday loans.

We performed our work from March 2004 through February 2005 in accordance with generally accepted government auditing standards.

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# Predatory Lending Findings from GAO-Led Focus Groups Held at 13 Installations

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We held focus group sessions at the 13 military installations we visited during the course of this engagement to obtain servicemembers' perspectives on a broad range of topics, including the impact of deployment on servicemembers' finances and the types of lenders military families use, along with the personal financial management (PFM) training and assistance provided to servicemembers by the Department of Defense (DOD) and service programs (see app. I for a list of installations visited). Servicemembers who participated in the focus groups were divided into three groups: junior enlisted personnel (pay grades E1 through E4), senior enlisted personnel (pay grades E5 through E9), and junior officers (pay grades O1 through O3). Although we requested to meet with servicemembers who had returned from a deployment within the last 12 months, some servicemembers who had not yet deployed also participated in the focus groups. At some installations, we also held separate focus groups with spouses of servicemembers. Most of the focus groups consisted of 6 to 12 participants.

We developed a standard protocol, with seven central questions and several follow-up questions, to assist the GAO moderator in leading the focus group discussions. The protocol was pretested during our first installation visit, and, after minor changes, was used at the remaining 12 installations. During each focus group session, the GAO moderator posed questions to participants who, in turn, provided their perspectives on the topics presented. We essentially used the same questions for each focus group, with some slight variations to questions posed to the spouse groups. Questions and sample responses are listed below.

We sorted the 2,090 summary statements resulting from the 60 focus groups into categories of themes through a systematic content analysis. First, our staff reviewed the responses and agreed on response categories. Then, two staff members independently placed responses into the appropriate response categories. A third staff member resolved any discrepancies.

In this report, we provide focus group participants' statements for only question 5—the one that asked participants about their experiences with predatory lenders.<sup>1</sup> Before the question was asked we attempted to provide participants with a general context for answering the question by reading

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<sup>1</sup>See [GAO-05-348](#), app. II, for participants' answers on the other six questions asked in the focus groups.

the following information: “Now we would like to talk about specific problems with predatory lenders. These include lenders that charge excessive fees and interest rates and those that lend without regard to borrowers’ ability to repay—usually lending to those with limited income or poor or no credit. Some payday lenders and fast checking places that charge high interest rates may fall into this category. Or a predatory lender could be a lender that commits outright fraud or deception—for example, falsifying documents or intentionally misinforming the borrowers about the terms of a loan, which may occur with unscrupulous car dealers.”

The themes and the number of installations for which a statement about a theme was cited are provided in italics below. Also, two examples of the statements categorized in the theme are provided. Only those themes cited at a minimum of three installations are presented. The number of installations—rather than the number of statements—is provided because (1) the focus of this engagement was on DOD-wide issues and (2) a lengthy discussion in a single focus group may have generated numerous comments.

5. What kinds of experiences have your fellow servicemembers or subordinates had with predatory lenders?

*A. Other issue regarding experiences with predatory lenders (N = 13)*

- Example: Businesses will tell young Marines that they can buy an item for a certain amount each month. They keep the Marine focused on the low monthly payments and not on the interest rate or the terms of the loan.
- Example: Some Marines feel that a business would not take advantage of them because they are in the military. This leads them to be more trusting of the local businesses than they should be, which in turn, leads the businesses to take advantage of them.

*B. Predatory lender used—car dealers (N = 11)*

- Example: Most of the participants stated that the car dealerships around base were the worst predatory lenders because they charge high interest rates and often provide cars that are “lemons.” They said that most of the sales people at the dealerships are former personnel who know how to talk to servicemembers to obtain their trust. Servicemembers do not expect this.

- Example: One captain had a Marine in his unit who signed a contract with a car dealer for a loan with a 26 percent interest rate. The captain took the Marine to the Marine Credit Union and got him a new loan with 9.5 percent interest.

*C. Predatory lender used—payday lenders (N = 10)*

- Example: A master sergeant got caught in the check-cashing cycle. He would write a check at one payday lender in order to cover a check written at another lender the previous week.
- Example: One participant shared that when he was a younger Marine he got caught up with a payday lender. The problem did not resolve itself until he deployed and was not able to go to the lender anymore.

*D. Reason for using predatory lender—get fast cash and no hassle (N = 10)*

- Example: People use payday lenders because they are quick and easy. All soldiers have to do is to provide their leave and earnings statement and they get the money.
- Example: Most of the participants say they know people that have used a payday lender and those soldiers use them because they have bad credit and can get quick cash.

*E. Predatory lender targeting—close proximity and clustering around bases (N = 9)*

- Example: It is almost impossible to be unaware of lenders and dealerships because many are clustered in close proximity to the installation. They also distribute flyers and use pervasive advertising in local and installation papers.
- Example: The stores and car lots near the installation have signs that say “E1 and up approved” or “all military approved” to get the attention of the military servicemembers.

F. *Command role when contacted by creditors (N = 8)*

- Example: The noncommissioned officers sometimes offer to go with the junior enlisted to places like car dealers; but, the young soldiers do not take them up on these offers.
- Example: One participant said that debt collectors do call his house and the command. He noted that one lender called him nine times in one day and his chief petty officer eventually asked the lender to stop harassing his sailor.

G. *Predatory lender targeting—advertising in installation/local newspaper (N = 7)*

- Example: Soldiers are being targeted by predatory lenders in a variety of ways; for example, flyers are left on parked cars at the barracks, advertising is present at installation functions, and words such as “military” are used on every piece of advertising to make the servicemember believe that the company is part of or supported by the military. The servicemember would normally trust lenders associated with the military.
- Example: Most predatory lenders have signs that say “Military Approved” or commercials that say the same thing or “E1 and above approved.”

H. *Reason for using predatory lender—urgent need (N = 6)*

- Example: Many soldiers use payday lenders because they are in a bind for money and they know these lenders can provide quick cash.
- Example: Soldiers will use a payday lender because they need money for a child, the kids, the house payment, etc. In many cases, it does not matter why they need it; they just need it. So, they go where they can get cash the fastest and the easiest way possible.

I. *Predatory lender used—furniture/rent-to-own (N = 6)*

- Example: One of the participants stated that he had obtained a loan to purchase a new washer and dryer. The loan had a 55 percent interest rate and the appliances cost a lot more than they should have.

- Example: Rent-to-own businesses are widely used by soldiers. One soldier ended up paying \$3,000 for an \$800 washer and dryer set.

*J. No problem with predatory lenders (N = 5)*

- Example: There have not been any problems with predatory lenders lately. The state of Florida has been using legislation to shut them down.
- Example: The participants said that they had never encountered an officer who had to use payday lenders or predatory lenders. According to the participants, most of the officers' problems come when they have a bitter divorce.

*K. Reason for using predatory lender—other reasons (N = 5)*

- Example: One soldier stated that his credit was so bad that he had no other option but to use high interest rate lenders. He stated that, "I have bad credit and I will always get bad credit."
- Example: One participant said he has several friends that use payday lenders because they are E1s or E2s and don't make much money.

*L. Predatory lender targeting—employing former military members (N = 4)*

- Example: The people running and working for the predatory businesses are usually former military servicemembers who use their knowledge of the system to take advantage of Marines.
- Example: Many times the predatory lenders are veterans, former Marines, or retirees. Using these types of people gives the younger Marines a false sense of trust and then the lenders will take advantage of the servicemember or stab the servicemember in the back.

*M. Reason for using predatory lender—command will not know financial conditions (N = 3)*

- Example: When a soldier needs money, a payday loan can be used without notifying the chain of command. Any form of assistance from



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**Appendix II**  
**Predatory Lending Findings from GAO-Led**  
**Focus Groups Held at 13 Installations**

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the Army requires a soldier to obtain approval from a dozen people before they can get any money.

- Example: The most significant reason that people use payday lenders is privacy. The spouses stated that to obtain assistance through the Air Force, you must use the chain of command to obtain approval. By doing so, everyone in the unit will know your business.

# Comments from the Department of Defense



PERSONNEL AND  
READINESS

OFFICE OF THE UNDER SECRETARY OF DEFENSE  
4000 DEFENSE PENTAGON  
WASHINGTON, D.C. 20301-4000



APR 12 2005

Mr. Derek B. Stewart  
Director  
Defense Capabilities and Management  
U.S. Government Accountability Office  
Washington, D.C. 20548

Dear Mr. Stewart:

This is the Department of Defense (DoD) response to the GAO draft report, GAO-05-349, 'MILITARY PERSONNEL: DoD's Tools for Curbing the Use and Effects of Predatory Lending Not Fully Utilized,' dated March 29, 2005 (GAO Code 350661)."

Comments on the two draft report recommendations are attached.

Sincerely,

Jeanne B. Fites  
Deputy Under Secretary of Defense  
Program Integration

Attachment:  
As stated



GAO-05-349/GAO CODE 350661

"MILITARY PERSONNEL: DOD'S TOOLS FOR CURBING THE USE  
AND EFFECTS OF PREDATORY LENDING NOT FULLY UTILIZED"

DEPARTMENT OF DEFENSE COMMENTS  
TO THE RECOMMENDATIONS

**RECOMMENDATION 1:** "The GAO recommended that the Secretary of Defense direct the Under Secretary of Defense for Personnel and Readiness to amend existing regulations to require installation commanders to convene the Armed Forces Disciplinary Control Boards at least semiannually to investigate and make recommendations to commanders on matters concerning eliminating conditions which adversely affect the health, safety, morals, welfare, morale, and discipline of the Armed Forces, to include Service members' use of lenders who may use predatory lending practices." . (Page 15/Draft Report)

**DoD RESPONSE: PARTIALLY CONCUR:**

This recommendation may inhibit the impact of payday lending in isolated situations, since the Armed Forces Disciplinary Control Board (AFDCB) provides a process that highlights issues with specific locations and proprietors, allowing an opportunity for the proprietor to take corrective action. However, due to the business model employed by payday lenders, the difficulty in providing adequate oversight of these businesses, and their prevalence outside military installations, the AFDCB process would be an ineffectual deterrent, even when fully deployed as defined in this recommendation.

**Business Model:** Payday lenders provide short term loans, without credit checks, at annual interest rates at or above 390%. These small loans cost the consumer approximately \$15 - \$20 per \$100 borrowed, if the loan is paid at the end of the two-week loan period. These loans become predatory as they are rolled-over, or as individuals engage in multiple loans of \$300 - \$500. The impact of roll-overs or multiple loans is to extend the individual far beyond their ability to payback the interest and principle, capturing the individual in a spiral of debt. These activities are legal in 35 states and would require the local command to develop criteria other than the state statutes to determine if the payday lender should be made off limits. The current Community Financial Services Association (CFSA) best practices mentioned in the report are not adequate criteria for determining acceptability. For example, the GAO report states that CFSA best practices limit the number of roll-over loans allowed. Their limit is 4 roll-overs, which produces an interest rate of 60% - 70%, which is unacceptable. For example, cost to a Service member for a loan for 8 weeks (4 roll-overs) for \$500 would be approximately \$300 - \$350. The Department of Defense is prepared to develop criteria that would prohibit roll-over and multiple loans.

**Providing Adequate Oversight:** Developing criteria outside of state statutes places the Department of Defense in the position of regulating business practices off of the

installation. Other similar situations, such as the monitoring of commercial insurance, have proven costly to administer, unpopular with both legislators and the industries concerned, and ineffectual due to limited surveillance capability. Surveillance, in order to ensure compliance with DoD regulations, would require local commands to periodically review each location in order to determine whether the outlet maintains programs within the criteria of the Department, or whether they have deterred Service members and their family members from using their products and services. In each circumstance, the Department has no legal recourse, other than making the facility off limits. If the location, having been made off limits, continues to offer products and services to Service members and their family members, local commands have no legal recourse to limit their activities.

**AFDCB Processes Would Be Ineffectual:** Finally, the AFDCB is established to review and consider whether to place a single location off-limits, as exemplified in the GAO report. Research accomplished by Steven M. Graves, Assistant Professor of Geography, California State University, Northridge, and Christopher L. Peterson, Assistant Professor of Law, University of Florida, Fredric G. Levin College of Law, illustrates that the number of payday lending outlets around military installations would overwhelm a process designed to review one location at a time. The chart, at Tab A, provides examples of the number of payday lending outlets in the top 30 counties and zip codes for payday lenders in 20 states, many of which are adjacent to military installations. In many cases there are over 50 payday lenders located around military installations. A process that requires a board to review so many locations on an individual basis would be unwieldy. To take action against one location and leave scores of other locations open to provide payday loans would have little impact on the problem. To consider evaluating all locations around a military installation as a single case would eliminate much of the due-process required in an AFDCB review, where the business is allowed to submit a letter to the Board and to negotiate a process that would allow the business to stay off of the off-limits list. Allowing one location to negotiate in an evaluation encompassing all locations around a military installation would require individual review of each location.

The business model established by payday lenders does not leave much room for negotiation. The local military command would have to establish rules, beyond state statutes and industry best practices, as the criteria for allowing payday lenders to remain open to military customers. The Department is not in the position to establish regulations to limit payday lenders and to provide the necessary oversight to ensure they comply. Furthermore the number of payday lenders around military installations makes the AFDCB process unwieldy for the purpose of reviewing and potentially making payday lenders off-limit businesses.

The Department has included payday lending as one of its top issues to discuss with state governments to encourage policies and statutes that assist and protect Service members and their families. Through the National Governors Association, the National Conference of State Legislature, the Conference of State Governments and American Legislative Exchange Council, as well as responding to representatives from several states, the Department has made legislators and administrators aware of its concerns over

payday lending. The Department has been encouraged to see several states have considered legislation to limit multiple and roll-over loans, limit annual percentage rates, and develop practices that allow Service members to negotiate more acceptable payback terms through credit counseling agencies. Through partnership with state governments, the appropriate agency can maintain the laws of the state to ensure Service members and their families are not abused by off-installation establishments.

Additionally, the rapid increase of payday lending in the past 15 years and its multistate nature suggest the need for strong federal legislation to limit or eradicate this high-cost form of borrowing that impacts all low-income consumers, not just low-ranking military members.

Also, beyond the specific problem of payday lending, two changes to the Armed Forces Disciplinary Control Board's (AFDCBs) joint regulation are in the initial stages of staffing and coordination by the executive agent for AFDCBs, the Army's Office of the Provost Marshall General. These changes are: 1) Direct that the AFDCBs meet quarterly to better engage the board and its constituent organizations in eliminating conditions that adversely affect the health, safety, morale, welfare, and discipline of the Armed Forces. 2) Direct that when one Service places a business "off limits," the rule will apply to all Services.

**RECOMMENDATION 2:** The GAO recommended that the Secretary of Defense direct the Assistant Secretary of Defense for Public Affairs to clarify the regulations pertaining to advertisements in installation publications by requiring disclaimers to be more prominent and taking steps to ensure advertisements reflect stated DoD policies regarding what it considers to be predatory lending. (Page 15/Draft Report)

**DoD RESPONSE: CONCUR**

Appendix III  
 Comments from the Department of Defense

**TAB A**  
 Analysis from “Predatory Lending and the Military: The Law and Geography of  
 “Payday” Loans in Military Towns

State	Installation	Number of payday lending locations	
		Within adjacent counties	Within adjacent zip codes
Alabama	Fort Rucker	68	42
	Maxwell AFB	96	19
	Redstone Arsenal	90	14
Arizona	Luke AFB		49
	Davis Monthan AFB		37
California	Twenty-Nine Palms USMC	161	7
	NAS Lemoore	90	13
	Edwards AFB	59	
	NS San Diego	238	28
	Camp Pendleton USMC	117	22
	Los Angeles AS	671	5
	Travis AFB	30	
	Beale AFB	5	
	Port Hueneme	34	
	Vandenberg AFB	19	
Colorado	Fort Carson	179	46
	Peterson AFB	129	36
	Schriever AFB	129	
	Buckley AFB	366	51
	USAF Academy		7
Delaware	Dover AFB	30	23
Florida	NAS Jacksonville	88	21
	NS Mayport	77	10
	MacDill AFB	138	15
	NAS Pensacola	22	
	Eglin AFB	17	
	Tyndall		5
Idaho	Mountain Home		4
Kentucky	Fort Campbell	18	8
	Fort Knox	22	44
Louisiana	Barksdale AFB	67	45
	Fort Polk	14	14
Missouri	Fort Leonard Wood	36	8
	Whiteman AFB		4
North Carolina	Seymour Johnson	30	11
	NCAS Cherry Point	19	6
	Camp LeJeune	14	10
	Fort Bragg/Pope AFB	39	25

**Appendix III  
Comments from the Department of Defense**

Ohio	Wright-Patterson AFB	30	17
Oklahoma	Tinker AFB	124	53
	Vance AFB	8	
	Altus AFB	4	
	Fort Sill	10	7
South Carolina	Shaw AFB	37	30
	MC Beaufort/Parris Island	21	4
	Charleston AFB	95	44
	Fort Jackson	72	45
South Dakota	Ellsworth AFB	42	40
Tennessee	Millington		32
	Milan Arsenal		8
Texas	Sheppard AFB	22	12
	NAS Corpus Christi	45	12
	Fort Bliss	61	19
	Goodfellow AFB	14	8
	Fort Hood	4	9
	Lackland AFB	124	9
	Fort Sam Houston	124	19
	Randolph AFB	124	
Virginia	Fort Lee	5	9
	Norfolk	230	50
	Fort Eustis	41	7
	Langley AFB	68	25
	Fort Story	102	11
Washington	Fairchild AFB	55	32
	Fort Lewis	75	24
	NS Bremerton	169	6
	McChord AFB	11	42
	NS Everett	173	2
	NAS Whidbey Island	23	

# GAO Contact and Staff Acknowledgments

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## GAO Contact

Jack E. Edwards (202) 512-8246

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## Acknowledgments

In addition to the individual named above, Leslie Bharadwaja, Alissa Czyz, Marion A. Gatling, Gregg Justice, III, David Mayfield, Brian Pegram, Minette Richardson, Terry Richardson, and Allen Westheimer made key contributions to this report.



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