

A 584% loophole in loan regulations

Lender: New credit program 'following the rules'

By Karen Jowers
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In spite of a new law that caps interest rates at 36 percent on consumer loans to military personnel, at least one lender is charging more — in this case, 584 percent interest.

"We're following the rules. We're doing what the Defense Department wants us to do," said Norman Faye, corporate secretary for Military Financial Inc.

The Military Lending Act, which took effect Oct. 1, imposed the new restrictions. But under Defense Department regulations that implement the new law, credit cards, overdraft loans, installment loans and all forms of open-end credit are excluded from the 36 percent cap.

Payday loans are considered closed-end loans — they are for a specific amount of time and have a specific repayment schedule.

Military Financial restructured its payday loan product Oct. 1, changing from a payday loan, which is covered by Pentagon restrictions, to an open-end revolving line of credit, which is not.

Therefore, "it is not under the onus of the 36 percent" interest rate limit, Faye said.

The Military Lending Act is much broader than the Defense Department regulations that implement it. The act covers everything except mortgage loans and loans that are secured by collateral. The Defense Department regulations cover title loans, payday loans and refund anticipation loans. At the time the regulations were written, officials said more restrictions could be added later, if needed, after numerous creditors voiced fears that the rules would limit the availability of credit that could help service members and their families.

Consumer advocates have called the Defense Department regulations too narrow and warned that lenders might restructure their loans to escape the rules.

Army Times Publishing Co. has pulled advertisements from Military Financial in all its Military Times newspapers.

"As soon as I was aware of the ad and what Military Financial was offering, I pulled the ad from publication," said Elaine Howard, president and CEO of Army Times Publishing Co. "We take letters from our readers seriously, investigate and take appropriate action if necessary. We are in this business because we believe in this community."

Reader blew the whistle

Howard learned of the details of Military Financial's loan program from a reader, Navy Lt. Cmdr. Steven Thomp-

son, commanding officer of the Navy Operational Support Center in Erie, Pa. After Thompson took one of his sailors to captain's mast for failure to meet financial obligations, he learned one of the sailor's lenders was Military Financial.

Thompson said he called the company for information about the product and was told it was not a loan. When pressed, he said, the customer service representative said a 1.6 percent fee is charged per day on the loan balance. That adds up to a 584 percent annual interest rate.

Thompson wrote to Navy Times to complain.

"When my sailor gets a loan at 584 percent, it's hurting my sailor," Thompson said. "You honestly have a responsibility to screen your advertisers because of the circulation you have. You care about us, and we read you. ... Your fine print [disclaimer in the advertising section] does not do enough."

Faye said the Military Financial loans are structured to be paid in four installments over four paydays, but borrowers can continue to draw on their credit line as they make payments.

The payment is reset as the borrower makes a payment or borrows more, Faye said. The 1.6 percent daily fee is paid on the remaining balance, he said.

Defense Department spokesman Army Lt. Col. Les Melnyk said Military Financial was "the only agency we have seen thus far changing its basic lending format to evade the restrictions." The Defense Department is reviewing regulations and will deliver a report to Congress in April, he said.

Faye contends the daily fee is not an interest rate. "Unfortunately we have to state it as an annualized interest rate," he said, because federal law requires all fees and costs of the loan to be included as an annualized percentage rate.

He argued his company could not afford to do business charging 36 percent annual interest, noting that would be a charge of 9.8 cents per day for every \$100 borrowed, rather than the current \$1.60.

But Thompson said his sailors can't afford to pay 584 percent interest. After canvassing the unit, he estimated about one-third of 100 sailors have overextended themselves financially.

Consumer advocates, while not aware of other firms that have changed their loan structure to avoid the 36 percent interest rate cap, said they are not surprised.


"Outside the military, there have been companies that developed products like this because states enacted laws with limits," said Lauren Saunders, managing attorney for the National Consumer Law Center. □

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