



GAO

Accountability \* Integrity \* Reliability

United States Government Accountability Office  
Washington, DC 20548

---

August 31, 2007

The Honorable Tim Johnson  
Chairman  
Subcommittee on Financial Institutions  
Committee on Banking, Housing, and Urban Affairs  
United States Senate

The Honorable Lindsey Graham  
Ranking Member  
Subcommittee on Personnel  
Committee on Armed Services  
United States Senate

Subject: *Military Personnel: DOD's Predatory Lending Report Addressed Mandated Issues, but Support Is Limited for Some Findings and Recommendations*

Serious financial problems can adversely affect unit morale and readiness as well as servicemembers' credit histories and military careers. If servicemembers experience serious financial problems, they may be subject to adverse actions such as loss of security clearances, criminal or nonjudicial sanctions, or adverse personnel actions including possible discharge from the military. The Department of Defense's (DOD) Social Compact, which is part of its human capital plan, notes that mission readiness and quality of life depend on whether servicemembers use their financial resources responsibly.<sup>1</sup> For these reasons, Congress and DOD officials have expressed concerns about servicemembers' financial conditions. DOD is particularly concerned about the use and effects of certain consumer loans that DOD identified as being predatory.

In April 2005, we reported about problems servicemembers were experiencing with personal financial management and the steps that DOD was taking to address those issues.<sup>2</sup> In another April 2005 report, we noted that DOD did not know the extent to which servicemembers were using consumer loans that DOD considered to be predatory, nor the effects of that usage.<sup>3</sup> Our report noted that DOD expressed concerns about four types of loans it labeled as

---

<sup>1</sup>DOD's Social Compact is a long-term quality of life strategy for the department. It promotes the advancement of the military community through the reciprocal ties that bind servicemembers, the military mission, and military families by responding to their quality of life needs as individuals and as members of a larger community. See DOD, Office of Military Community and Family Policy, *A New Social Compact: A Reciprocal Partnership between the Department of Defense, Service Members and Families* (July 2002).

<sup>2</sup>GAO, *Military Personnel: More DOD Actions Needed to Address Servicemembers' Personal Financial Management Issues*, GAO-05-348 (Washington, D.C.: Apr. 26, 2005).

<sup>3</sup>GAO, *Military Personnel: DOD's Tools for Curbing the Use and Effects of Predatory Lending Not Fully Utilized*, GAO-05-349 (Washington, D.C.: Apr. 26, 2005).

predatory—payday, rent-to-own, automobile title pawn, and tax refund loans. These financial products are typically offered by lenders that are outside the system of federally insured financial institutions. Although “predatory lending” has no precise definition, some practices (such as charging excessive fees or interest rates and repeatedly refinancing loans without economic gain for the borrower) are widely regarded as predatory. We also reported that DOD and active duty servicemembers have not fully used DOD’s existing tools for curbing the use and effects of predatory lending practices. To correct identified problems in DOD’s programs for addressing predatory lending practices, we recommended actions that would (1) clarify to servicemembers that DOD does not endorse the advertisers in installation newspapers and (2) make greater use of Armed Forces Disciplinary Control Boards which can place businesses off limits to servicemembers if the businesses adversely affect the servicemembers’ health, safety, morals, welfare, morale, and discipline. DOD concurred with the first recommendation and partially concurred with our second recommendation, noting constraints faced in using the boards.

The 2006 National Defense Authorization Act required DOD to issue a report on predatory lending directed at servicemembers and their dependents.<sup>4</sup> The mandate required DOD’s report to include: (1) a description of the prevalence of predatory lending practices directed at servicemembers and their families; (2) an assessment of the effects of predatory lending on servicemembers and their families; (3) a description of DOD’s strategies and programs to educate servicemembers and their families about predatory practices; (4) a description of DOD’s strategies and programs to reduce or eliminate the prevalence of predatory lending practices directed at servicemembers and their families, as well as the negative effects of such practices; and (5) recommendations for additional legislative and administrative action to reduce or eliminate predatory lending practices. The act further specified that DOD was to prepare its report in consultation with the Secretary of the Treasury, the Chairman of the Federal Reserve, the Chairman of the Federal Deposit Insurance Corporation, and representatives from military charity organizations, and consumer groups and submit it to Congress within 180 days of the legislation’s enactment. DOD issued the mandated report on August 9, 2006.<sup>5</sup> Following the submission of DOD’s report, Congress added a new section to Title 10 of the U.S. Code which sets out a number of limitations and requirements related to terms of consumer credit extended to servicemembers and their dependents.<sup>6</sup> Many of the provisions in this section mirror the recommendations in DOD’s report. This statute required the Secretary of Defense to create regulations to implement the new provisions, and, in response to that requirement, DOD has published in the *Federal Register* some proposed rule changes that would limit the terms of consumer credit extended to servicemembers and their dependents.<sup>7</sup> These proposed regulations are expected to be effective October 1, 2007.

Following the publication of DOD’s 2006 report, private-sector groups associated with segments of the financial industry raised concerns about the report’s preparation, quality, and recommendations. You requested that we review DOD’s 2006 report on predatory lending practices. Specifically, we evaluated DOD’s approach and support in preparing its mandated report on predatory lending practices. This report documents findings that we briefed to your offices on August 17, 2007. Enclosure I contains the briefing slides we presented. This

---

<sup>4</sup>National Defense Authorization Act for Fiscal Year 2006, Pub. L. No. 109-163, § 579 (2006).

<sup>5</sup>DOD, *Report On Predatory Lending Practices Directed at Members of the Armed Forces and Their Dependents* (Washington, D.C.: Aug. 9, 2006).

<sup>6</sup>The John Warner National Defense Authorization Act for Fiscal Year 2007, Pub. L. No. 109-364, § 670 (2006), added Section 987 to Title 10 of the U.S. Code.

<sup>7</sup>Limitations on Terms of Consumer Credit Extended to Service Members and Dependents, 72 Fed. Reg. 18157 (proposed Apr. 11, 2007) (to be codified at 32 C.F.R. pt. 232).

briefing contributes to a larger GAO body of work on compensation and financial conditions of military personnel (see the list of related GAO products at the end of this report).

In conducting our review, we limited the scope of our work to the types of loans that DOD identified as being predatory in its mandated 2006 report. We examined legislation that mandated the DOD report and regulations such as governmentwide and DOD-wide standards for data quality. In addition to reviewing DOD's predatory lending report and the reports cited in that study, we reviewed GAO, Congressional Research Service, and Federal Deposit Insurance Corporation Office of the Inspector General reports on related issues. We developed a tool to systematize our analysis of the quality of research studies and data sources DOD used as support in its report. We interviewed representatives and obtained documents from DOD and the federal agencies, military charity organizations, and consumer groups involved in the preparation of DOD's report as well as other groups whose perspectives were different from those provided in the DOD report. As an additional means for examining the support for DOD's report, we conducted a site visit at one installation for each of the four active duty services. Enclosure II describes our scope and methodology in more detail. We performed our work between March 2007 and August 2007 in accordance with generally accepted government auditing standards.

## **Summary**

DOD issued a report on predatory lending that addressed the mandated issues, but it contained limited support for some of its findings and recommendations. As required by the mandate in the 2006 National Defense Authorization Act, DOD issued its report in August 2006 addressing the five required elements after consulting with the organizations and groups specified in the act. Among the points that DOD made are that predatory lending practices are prevalent and target military personnel and that the department is exerting significant effort to educate servicemembers on the potential dangers of using predatory loans. All mandated organizations and groups stated that they had commented on DOD's report, although DOD appears to have consulted with military charity organizations and consumer groups more than with the federal agencies identified in the report. DOD's report did not describe the content and extent of the consultations or make note of any concerns raised by those groups. The report's authors indicated that they had to rely largely on previously gathered data and may have done some things differently if they had had more time. Additionally, representatives for one of the consulted federal agencies noted that DOD faced a short timeframe to prepare its report and basically met the legislative requirements. Even though DOD provided several sources illustrating the negative effect that predatory loans have on servicemembers, our evaluation of the DOD report revealed methodological problems in some of its analyses and in some of the studies cited in its report, particularly for the description of the prevalence and assessment of the effects of predatory lending practices. For example, the DOD report's prevalence section provided several metrics that did not directly assess whether servicemembers actually (1) used the loan type and (2) considered the associated lending practices to be predatory. As we noted in our 2005 report on predatory lending, the extent to which active duty servicemembers use consumer loans considered to be predatory and the effects of such borrowing are unknown, but some of the information provided in the DOD report and obtained during our 2007 site visits suggests that some servicemembers can pay substantial sums for the loans. DOD's report also showed the percentages of servicemembers who use loans that it had characterized as predatory and the percentage of servicemembers who experienced financial difficulties. It did not include an analysis of the relationship between the two types of information. In its sections on education and strategies to reduce or eliminate the prevalence and negative effects of predatory lending practices, the DOD report documented the broad array of financial education classes and other programs offered. While the report linked the large numbers of financial education classes and materials provided to servicemembers and their families to

increased awareness and reduced usage of predatory loans, DOD has not implemented procedures for evaluating outcomes from its training programs as we recommended in 2005. For example, tools such as required personal financial management training for all servicemembers arriving at their first duty station, alternative loan programs from military charity organizations, and financial counseling are readily available to servicemembers; however, our 2005 report noted and our site visits in 2007 found that some servicemembers underutilize these resources because, in part, they do not want their command to know about their financial problems. DOD's report included six recommendations for additional legislative and administrative actions, such as setting a 36 percent annual percentage rate cap for loans to military borrowers and requiring unambiguous and uniform price disclosures. While these recommendations may have merit, they were not directly linked to the report's findings, were based on research studies that had some methodological problems, or did not address implementation issues. Similarly, DOD proposed the recommendations without discussing the feasibility of implementing and enforcing the recommendations. While DOD's report addressed the requirements in the mandate, the shortcomings we identified in some of the methods and approach indicate that caution is necessary when interpreting the findings for some areas of DOD's report.

### **Agency Comments and Our Evaluation**

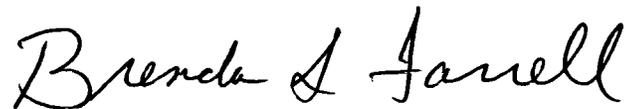
On August 21, 2007, we provided a draft of this report to DOD for review and comment. The Office of the Under Secretary of Defense for Personnel and Readiness provided the following comments.

“The Department stands by the content and recommendations in its August 9th, 2006, *Report to Congress on Predatory Lending Practices Directed at Members of the Armed Forces and Their Dependents*. While more research is always a laudable objective, GAO's existing findings, as it acknowledges, point to the same conclusion the Department and the Congress reached: We need to act to protect our Service personnel from predatory lending practices.”

Contrary to DOD's comments, our report neither acknowledged nor disagreed with DOD's conclusion stated above. While actions may be needed to protect servicemembers from predatory lending practices, our report did not endorse or reject any action recommended in DOD's report. The scope of our work was limited to evaluating DOD's approach and support in preparing its mandated report on predatory lending practices.

As agreed with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 4 days after its issue date. At that time, we will provide copies of this report to interested congressional committees and the Secretary of Defense. 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 have any questions about this report or need additional information, please contact me at (202) 512-3604 or [farrellb@gao.gov](mailto:farrellb@gao.gov). Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Key contributors to this report are listed in enclosure III.

A handwritten signature in black ink that reads "Brenda S. Farrell". The signature is written in a cursive style with a large initial 'B' and a distinct 'S'.

Brenda S. Farrell  
Director  
Defense Capabilities and Management

**Briefing Slides**



---

**Military Personnel: DOD's Predatory Lending Report Addressed  
Mandated Issues, but Support Limited for Some Findings and  
Recommendations**

---

**Briefing to Congressional Requesters**

**August 17, 2007**

---

---

Introduction/Background

Objective, Scope, and Methodology

GAO Observations

- DOD **Consultations** during Report Preparation
- DOD Addressed Five Elements in Its Report<sup>1</sup>
  - Description of the **prevalence** of predatory lending practices,
  - Assessment of the **effects** of the practices,
  - Description of DOD’s strategy and programs to **educate** servicemembers and their families regarding the practices,
  - Description of DOD’s **strategy** and programs to reduce or eliminate the prevalence and negative effects of the practices, and
  - **Recommendations** for additional legislative and administrative action to reduce or eliminate the practices.

---

<sup>1</sup> The mandate required DOD to report on predatory lending practices directed at servicemembers and families for each element. Our observations are typically applicable to both servicemembers and families, except for some unique points about education training for family members.

- The Department of Defense's (DOD) Social Compact, which is part of its human capital plan, notes that mission readiness and quality of life depend on whether servicemembers use their financial resources responsibly.<sup>2</sup>
- If servicemembers experience serious financial problems, they may be subject to adverse actions such as loss of security clearances, criminal or non-judicial sanctions, or adverse personnel actions including possible discharge from the military.
- Serious financial problems can adversely affect unit morale and readiness as well as servicemembers' credit histories and military careers.<sup>3</sup>

<sup>2</sup> DOD, Office of Military Community and Family Policy, *A New Social Compact: A Reciprocal Partnership between the Department of Defense, Service Members and Families* (July 2002).

<sup>3</sup> GAO, *Military Personnel: More DOD Actions Needed to Address Servicemembers' Personal Financial Management Issues*, GAO-05-348 (Washington, D.C.: Apr. 26, 2005).

In our April 2005 report that addressed predatory lending practices and servicemembers,<sup>4</sup> we noted:

- “Predatory lending” has no precise definition, but some practices (such as charging excessive fees or interest rates and repeatedly refinancing loans without economic gain for borrower) are widely regarded as predatory.
- DOD officials expressed concerns about four types of consumer loans (**payday, rent-to-own, automobile title pawn, and refund anticipation**) that DOD labeled as predatory. These loans are typically provided by lenders that are outside the system of federally insured financial institutions. These loans provide 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 types of loans are generally much higher than those charged by traditional financial institutions, and other loan terms and conditions are often unfavorable to the borrower. Descriptive information on these four types of consumer loans follows.

<sup>4</sup> GAO, *Military Personnel: DOD's Tools for Curbing the Use and Effects of Predatory Lending Not Fully Utilized*, GAO-05-349 (Washington, D.C.: Apr. 26, 2005).

- **Payday loans**, according to the Federal Deposit Insurance Corporation (FDIC), 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>5</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 higher than the retail price.<sup>6</sup>

<sup>5</sup> According to the Federal Reserve Bank of Philadelphia, fees for a payday loan range from \$15 to \$30 for 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 the borrower paying \$75 in fees in addition to repaying the borrowed \$100.

<sup>6</sup> *Survey of Rent-to-Own Customers*, Federal Trade Commission Bureau of Economics Staff Report (undated).

- **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.
- **Refund anticipation loans** provide cash loans against the borrower's expected income tax refund.
  
- DOD did not know the extent to which servicemembers use consumer loans that it considered to be predatory or what the effects of that borrowing were, at the time of our April 2005 report.
  
- Although DOD had tools in place to curb the use and effects of predatory lending practices in 2005, DOD and active duty servicemembers had not fully used its tools, such as a panel that can place a business off-limits to servicemembers.

The National Defense Authorization Act for Fiscal Year 2006 mandated DOD to submit a report on predatory lending practices directed at servicemembers and their families and required:<sup>7</sup>

- **Consultation** with the Secretary of the Treasury, the Chairman of the Federal Reserve, the Chairman of the FDIC, military charity organizations, and consumer organizations;
- Information on the following five elements regarding predatory lending practices directed at servicemembers and their families :
  - Description of the **prevalence** of predatory lending practices,
  - Assessment of the **effects** of the practices,
  - Description of DOD’s strategy and programs to **educate** servicemembers and their families regarding the practices,
  - Description of DOD’s **strategy** and programs to reduce or eliminate the prevalence and negative effects of the practices, and
  - **Recommendations** for additional legislative and administrative action to reduce or eliminate the practices; and
- Issuance of the report no later than 180 days after enactment of the legislation.

<sup>7</sup> National Defense Authorization Act for Fiscal Year 2006, Pub. L. No. 109-163, § 579 (2006).

DOD published its *Report on Predatory Lending Practices Directed at Members of the Armed Forces and Their Dependents* on August 9, 2006. Among the points made in the report were:

- The report had been prepared with assistance from the specific agencies and types of organizations specified in the mandate.
- Predatory lending practices are prevalent and target military personnel.
- Efforts are on-going to persuade servicemembers “not to fall victim to the lure of easy credit to solve their financial concerns” and to consider better options.
- The department is exerting significant effort to educate servicemembers on the potential dangers of using predatory loans and better ways of managing their finances.
- Commanders are using the methods available to them (such as loans available from military charity organizations) to curtail the prevalence of predatory loans.
- DOD is seeking protections for servicemembers by proposing six recommendations for statutory controls.

**Objective**

- For this report, we evaluated DOD's approach and support in preparing its mandated report on predatory lending practices.

**Scope**

- We limited our work to the types of loans that DOD identified as being predatory in its mandated report.
- We focused on active duty servicemembers based on DOD's use of survey results and other data on active duty servicemembers.

**Methodology**

To address our objective, we:

- Examined the 2006 legislation mandating the DOD report and regulations such as government-wide and DOD-wide standards for data quality;
- Reviewed reports on related issues from GAO, other agencies, and non-governmental organizations;

- Constructed and used an evaluation tool to systematically analyze the methodological soundness of some research studies and data sources that DOD used in its report;
- Interviewed responsible DOD and service officials and representatives from the U.S. Treasury, Federal Reserve, FDIC, military charity organizations, and consumer organizations that were consulted by DOD in its report preparation;
- Held discussions with groups such as the Center for Regulatory Effectiveness and a payday lending association to understand perspectives that differed from those provided in DOD's report;
- Conducted a site visit at one installation for each of the four active duty services and used structured protocols to conduct individual interviews and group discussions with personnel representing installation leadership, legal assistance, finance, senior enlisted supervisors, financial counselors and trainers, and the military aid/relief unit representatives; and
- Performed our work between March 2007 and August 2007 in accordance with generally accepted government auditing standards.

**DOD's 2006 report indicated and our follow-up discussions confirmed that the mandated agencies and organizations were consulted, but the report did not describe the content and extent of the consultations or make note of any concerns raised by those groups.**

- The representatives for the mandated federal agencies stated that they had reviewed a draft of DOD's report but did not participate during its preparation.
  - Federal Reserve representatives stated that DOD orally described the report and gave them a whole draft to review. Federal Reserve staff:
    - provided general comments, but did not help with the report's content,
    - had no official opinion on the report since it was based on DOD's research and studies of predatory loans on servicemembers, and
    - did not help DOD formulate the recommendations nor did the Federal Reserve endorse them.
  - FDIC representatives stated they reviewed the whole draft report and
    - made general comments to DOD, and
    - suggested that DOD add information on both alternative loan products and FDIC's conference, "Meeting the Needs: Affordable, Responsible Short-Term Lending," which DOD agreed to do.

- Treasury representatives stated that they reviewed the whole draft report after DOD had developed it and
  - provided general rather than substantive comments on the draft report,
  - commented on the potential negative effect that DOD’s recommended limitations on credit may have on overall credit availability to servicemembers, and
  - asked DOD to document in its report that the recommendations apply only to military servicemembers.
- Military charity organizations’ officials noted they provided input to the report’s authors during its preparation and generally supported its content.
  - Army Emergency Relief officials said their comments were editorial, and they basically concurred with the draft.
  - Navy/Marine Corps Relief Society officials said they agreed “wholeheartedly” with DOD’s recommendations.
  - Air Force Aid Society official noted that the report reflected her experience regarding the impact of predatory lending products on young military families and concurred with the report’s recommendations.

- Consumer group representatives met with DOD officials and provided the history of predatory lending products and research studies.
  - A Consumer Federation of America representative stated she provided
    - the information about Internet payday loan and installment lenders contained in Appendix 3 of DOD’s report,
    - gave feedback about her areas of expertise (such as about payday loans), and
    - did not comment on DOD’s research.
  - A Center for Responsible Lending representative stated that he was very conscientious about not wanting to influence DOD and, therefore, he and his staff
    - provided DOD with the history and definition of abusive lending practices and a discussion on consumer protection and advocacy,
    - had differences of opinion with DOD regarding lending products and predatory practices, and
    - were concerned that the recommendations were so strict that the small loan product (payday loans) could morph into something else or the lenders could find loopholes.
  - A National Association of Consumer Advocates representative provided data to DOD and thought that the recommendations in DOD’s report are “completely appropriate.”

- The 180-day requirement for issuing the DOD report may have contributed to some of the concerns identified in this and later sections of our evaluation.
  - The authors of the DOD report indicated that they had to rely largely on previously gathered data and may have done some things differently if they had had more time.
  - In addition, Treasury representatives noted that DOD faced a short timeframe to prepare the report and basically met the legislative requirements.

**The DOD 2006 report's prevalence section discussed six types of loan products with associated predatory practices and provided several metrics that did not directly assess whether servicemembers actually (1) used the loan type and (2) considered the associated lending practices to be predatory.**

- DOD's 2006 report added two types of predatory loans—military installment loans and Internet lending—to the four types—payday loans, rent-to-own loans, automobile title pawn loans, and tax refund anticipation loans—that the Department had identified when we published our April 2005 report (see GAO-05-349) on predatory lending.
- DOD does not have comprehensive data for quantifying the extent to which servicemembers use any of the six types of loan products that DOD considers predatory. DOD's report identified limitations such as the difficulty in ascertaining the use of payday loans by active duty servicemembers and their families. We noted similar concerns in our 2005 report on predatory lending and found similar data limitations during our 2007 site visits.

- DOD's report inferred the prevalence of predatory lending practices by using at least three types of metrics. The accuracy of the inferences associated with these metrics is unclear.
  - **Servicemembers' self-reported usage of a loan product:** DOD survey results, like those we examined in 2005 (GAO-05-349), illustrate the percentages of servicemembers who had payday loans, which may not be the same thing as the percentage of servicemembers who would have characterized their loans as predatory. However, during our 2007 discussions with installation leaders and servicemembers, they emphasized negative experiences with these types of loans.
  - **Geographic proximity of storefronts:** DOD also inferred prevalence using findings from a research study that examined the geographic proximity of loan storefronts to military installations. Our evaluation of that study suggests that its descriptive analyses did not provide sufficient evidence to support DOD's perceptions and conclusions that (1) concentration of storefronts around installations suggest servicemembers were being targeted more so than other groups of potential customers at other locations or (2) proximity implies only servicemember usage. Alternatively, civilians working on or near the installations could be targets also. While the study did not definitively prove that lenders are targeting servicemembers, we observed during our 2007 site visits that some lender storefronts are in close proximity to bases and their advertising was often targeted to servicemembers.

- **Estimated number of active-duty servicemembers with predatory loans:** DOD used industry data to estimate that servicemembers are three times more likely than civilians to have taken out a payday loan, but there is no way to verify the accuracy of the industry data. However, our analysis of DOD’s calculations using the industry data found that DOD’s analysis was reasonable with the limitation that industry estimates of payday borrowers were not examined.
- As we reported in 2005 (GAO-05-349), DOD’s efforts to assess the prevalence of predatory lending practices directed at servicemembers and their families 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;
  - imprecision in the way questions are asked on DOD’s surveys; and
  - privacy considerations and the reluctance of most servicemembers to discuss their financial difficulties with their command.

**Although DOD's 2006 report did include an analysis of predatory loan use and financial difficulties among servicemembers and their families, it did not include an analysis of the relationship between the two.**

- Analytical and methodological limitations constrain the conclusions that can be drawn from the DOD-wide survey results and the case studies detailed in the effects section.
- Using the survey results, DOD separately analyzed the percentages of active duty servicemembers who had (1) experienced financial problems such as bouncing checks and having utilities shut off and (2) used four types of predatory loan products.<sup>8</sup> However, the report did not address the relationship between financial problems and predatory loan usage by showing
  - the percentages of servicemembers reporting financial problems who had predatory loans as compared to those that did not have predatory loans, or
  - the percentages of servicemembers with predatory loans who reported financial problems as compared with those that did not report financial problems.

<sup>8</sup> The active duty survey gathered information about the four types of lending products DOD identified as predatory in 2005.

- Seventeen anecdotal case studies gathered specifically for the report via an installation-level data call were used to provide context on the effects of predatory loan use among servicemembers. However, the case selection methodology for choosing these 17 cases from the 3,000+ case studies was limited in that it provided for only one scenario of predatory loan use.
  - Specifically, the installation-level data call requested only “detail about a servicemember and/or a family member who has suffered from a predatory loan” rather than requesting examples of both negative and positive effects.
  - The report authors acknowledged that the
    - installation-level data call was not a statistical, generalizable sample and
    - 17 case studies were selected because they told the “full story” of using a predatory loan.
  - Despite these methodological limitations, the case studies do illustrate that some servicemembers can pay substantial sums for the loans— money that could be used to meet other financial needs.
- As we reported in 2005 (see GAO-05-349), DOD’s inability to quantify the effects of using the loan products is due in part to the data problems that we discussed earlier in the prevalence section of this briefing. Being able to identify the population of servicemembers who use the products is essential for determining the negative as well as positive effects of using the loans that DOD has characterized as predatory.

**DOD's 2006 report linked the large numbers of financial education classes and materials provided to servicemembers and their families to increased awareness and reduced usage of predatory loans, but DOD—like other federal agencies—has a continuing need to implement procedures for evaluating outcomes from its training programs.**

- The report provided statistics documenting the services' efforts in 2005 to educate servicemembers and their families about financial issues that included predatory lending. For example,
  - The services offered more than 10,000 classes in which predatory lending topics were covered, and external organizations such as on-installation banks and credit unions offered more than 1,000 additional courses on these topics.
  - Together, the services and the external organizations distributed nearly 225,000 pieces of financial education materials.
  - The services delivered nearly 1,000 news articles addressing predatory lending to local base papers and base bulletins, and they promulgated more than 150 policy memos addressing financial issues.

- The report emphasizes that financial education occurs throughout the military.
  - DOD requires all servicemembers to take personal financial management training within 3 months of arriving at the first permanent duty station.
  - Prior to assuming a leadership role as a supervisor, officers and noncommissioned officers receive financial training and are expected to demonstrate a basic understanding of related policies and practices designed to protect junior servicemembers.
  - The DOD report shows that while servicemembers' families are also offered financial training, they attended at much lower levels than did servicemembers. During our 2007 site visits, installation personnel noted that it is difficult to get family members to attend the voluntary financial management classes.
  
- Since May 2003, DOD's Financial Readiness Campaign has partnered with approximately 20 federal agencies and nonprofit organizations to provide materials and assistance to the services and, among other things, increase financial awareness and abilities, increase savings, and reduce dependence on credit.

- As we reported in 2005 (GAO-05-348), some junior enlisted servicemembers are not receiving the required personal financial management training.
  - Our 2007 site visits found that the services do not consistently track attendance to ensure that all servicemembers attend the required training.
  - Our discussions with senior noncommissioned officers and other program officials at four installations visited in 2007 found that financial education training may not occur because of competing needs such as completing deployment-related training.

- We also noted in our 2005 report (GAO-05-348) that DOD does not have outcome-related measures to determine whether personal financial management training helps servicemembers manage their finances better.
  - We therefore recommended that DOD
    - develop and implement, in conjunction with the services, a DOD-wide oversight framework with a results-oriented evaluation plan for the personal financial management programs and formalize DOD's oversight role by including evaluation and reporting requirements in the personal financial management instruction; and
    - require the services to develop and implement a tactical plan with time-based milestones to show how the appropriate service policy office will monitor financial management training and thereby ensure that junior enlisted servicemembers receive the required training.
  - Although DOD concurred with these recommendations, it has not implemented them.
- Shortcomings in training evaluation are not unique to DOD. In a 2006 GAO letter<sup>9</sup> to Congressional leadership suggesting high priority areas of oversight for the 110th Congress, we noted a need to enhance and improve all federal agencies' abilities to evaluate financial literacy programs and determine if they promote positive behavioral change.

<sup>9</sup> GAO, *Potential Oversight Issues: Suggested Areas for Oversight for the 110th Congress*, GAO-07-235R (Washington, D.C.: Nov. 17, 2006).

**DOD's 2006 report describes a broad array of tools provided to servicemembers to help reduce or eliminate the prevalence and effects of predatory lending practices; however, some of the tools may be under-utilized.**

- The report noted that DOD has worked with the military charity organizations and on-installation banks and credit unions to provide alternatives to predatory loans. For instance,
  - The military charity organizations indicated that they provided about 100,000 grants and no-interest loans worth nearly \$90 million to servicemembers in 2005.
  - 24 on-installation financial institutions documented examples of small, short-term, and lowered interest alternatives that they made available specifically for servicemembers.
  - Despite these substantial efforts and available resources, our 2005 report (GAO-05-349) as well as site visits in 2007 found that servicemembers may choose to use non-DOD resources if, for example, they do not want the command to be aware of their financial conditions.

- Free credit counseling and debt management services are another part of DOD's strategy to reduce or eliminate the prevalence and effects of predatory lending practices.
  - Installations provide credit counseling through family support programs.
  - DOD also makes confidential, 24-hour, 7-days-a-week credit counseling available through toll-free telephone and Web access to DOD's Military OneSource.
  - Although not mentioned in DOD's report, information obtained in our 2007 site visits also indicated that military charity organizations may similarly help servicemembers with tasks such as developing budgets as a step in awarding a grant or no-interest loan.
  - The DOD report additionally cites special emphases that Navy and Marine Corps leaders have placed on eliminating any stigma that might have formerly been associated with servicemember financial problems. During our 2007 site visits, several installation leaders stated that they are encouraging servicemembers to use available installation resources, such as command personal financial specialists and military charity organizations, without fear of repercussions.

- The DOD report reiterates a point previously made in our 2005 report (GAO-05-349)—Armed Forces Disciplinary Control Boards have been used in a limited number of instances to place or threaten to place a lender off-limits to servicemembers. One reason for this infrequent use is that the boards may have little basis to take actions against lenders that DOD considers as predatory if the lenders operate within state laws.
  
- Even though DOD has a robust set of tools for curbing predatory lending practices and their effects, our 2005 report (GAO-05-349) concluded that servicemembers under-utilize those resources.
  - We found that free legal assistance—a useful tool that was not mentioned in the DOD report—is available to review contracts and other financial documents, but servicemembers might not use this assistance.
  - We identified multiple reasons for the under-utilization, such as servicemembers’ desires to make purchases immediately.

**DOD's 2006 report included six recommendations for additional legislative and administrative actions; while these recommendations may have merit, they were not directly linked to the report's findings, were based on research studies that had some methodological problems, or did not address implementation issues.**

- In the DOD report section that preceded the recommendations, DOD concluded that it cannot prevent predatory lending without assistance from Congress, the state legislatures, and federal and state enforcement agencies. DOD also commented on issues such as rollover of loans and usury laws.
- DOD's report provided six recommendations that it concluded will protect servicemembers and their families from predatory lending abuses:
  - Require unambiguous and uniform price disclosure for extension of credit,
  - Require a federal ceiling on the cost of credit to military borrowers,
  - Prohibit extending credit without regard to ability to repay,
  - Prohibit provisions in loan contracts that require servicemembers and their families to waive their rights to take legal action,
  - Prohibit contract clauses that require servicemembers and their families to waive any special legal protections, and
  - Prohibit states from discriminating against servicemembers and their families stationed within their borders and prohibit lenders from making loans to servicemembers that violate state consumer lending protections.

- There is limited transparency to show the basis for some of the recommendations in the DOD report.
  - After being unable to identify a clear link between reported findings and recommendations, we asked the DOD authors to identify the portions of the report supporting each recommendation.
  - Although DOD subsequently provided us with a list of pages containing information purported to support each recommendation, we were still unable to link some recommendations to supporting documentation.
- Methodological problems in some of DOD's analyses and in some of the studies cited in DOD's report suggest that some recommendations may not be grounded in sound research.
  - Throughout this evaluation, we have noted some methodological concerns such as those associated with the measurement of prevalence and effects.

- Other methodological problems were also present. For example,
  - DOD based some of its recommendations on Appendix 3 of its report; however, the methodology used to select the Web sites of lenders listed in this appendix was not statistically representative of a defined universe of such lenders. For example, Appendix 3 notes that the 18 listed are a small sample of Internet lenders. DOD’s report states that an on-line search for “military loans” got more than 38 million hits. Therefore, the findings based on this appendix cannot be generalized beyond the 18 sites that were reviewed.
  - DOD combined information from two samples and drew generalizations that were not methodologically sound about payday loan use by all enlisted personnel.
- Financial markets specialists at GAO examined the six recommendations and noted DOD’s report did not address the feasibility of implementing and enforcing the recommendations, which could cause challenges.
- While DOD’s report included a strategy for personal finance to increase servicemembers’ awareness, it did not identify any additional changes that could be made to DOD’s current financial education programs that would make these programs more beneficial.

## Scope & Methodology

### Scope

In conducting our evaluation of DOD's report on predatory lending, we limited the scope of our work to the types of loans that DOD identified as being predatory in its mandated report. This includes payday loans, rent-to-own loans, automobile title pawns, tax refund loans, military installment loans, and Internet lending. Our work focused on active duty servicemembers as in our April 2005 reports. While DOD's report does not specify that some parts of its report pertain to only active or reserve personnel, we focused on active duty servicemembers based on DOD's use of survey results and other data on active duty servicemembers.

### Methodology

To address our objective, which was to examine the approach and support for DOD's report, we examined legislation that mandated the DOD report and regulations such as governmentwide and DOD-wide standards for data quality. In addition to reviewing DOD's predatory lending report and the reports cited in that study, we reviewed and analyzed findings and perspectives contained in publications on related issues by GAO, the Congressional Research Service, Federal Reserve Board staff in Washington, D.C., Federal Deposit Insurance Corporation's Office of Inspector General, consumer groups (Consumer Federation of America and Center for Responsible Lending), and an association (Community Financial Services Association of America) that says it represents more than 50 percent of payday lenders. DOD, service, and installation officials also provided additional views and documents pertaining to the prevalence and effects of predatory lending practices, programs and current strategies to educate servicemembers and their families about those practices, current strategies and programs for reducing or eliminating the prevalence and effect of predatory lending practices, and recommendations for legislative and administrative actions to reduce or eliminate the prevalence and effects of predatory lending practices.

In addressing our objective, we conducted interviews with and obtained documents from the officials in DOD's Office of the Under Secretary of Defense for Personnel and Readiness who were responsible for preparing the report, and service policy officials. We also interviewed representatives from organizations that DOD consulted while developing its report (see table 1), and in some cases obtained related documentary evidence concerning their input during DOD's preparation of its report. We also held discussions with groups such as the Center for Regulatory Effectiveness and Community Financial Services Association of America, a payday lending association, to understand perspectives that were different from those provided in the DOD report. Additional perspectives were obtained from the public comments that other groups (e.g., other consumer groups and the lending industry) provided in response to proposed regulations that DOD published in the *Federal Register* on April 11, 2007.

**Table 1: Organizations Supplying Information about Their Consultations with DOD during the Preparation of Its Mandated Report**

Type of organization	Organization and location of the representative(s) interviewed
Federal agencies	Federal Reserve, Washington, D.C.
	Treasury Department, Washington, D.C.
	Federal Deposit Insurance Corporation, Washington, D.C.
Military charities	Army Emergency Relief, Alexandria, Virginia
	Navy/Marine Corps Relief Society, Arlington, Virginia
	Air Force Aid Society, Arlington, Virginia
Consumer groups	Consumer Federation of America, Washington, D.C.
	Center for Responsible Lending, Washington, D.C.
	National Association of Consumer Advocates, Washington, D.C.
	National Consumer Law Center, Boston, Massachusetts

Source: GAO.

To further address our objective, we conducted site visits at the four installations shown in table 2. The team decided to select a nonprobability sample of four military installations—one per active duty DOD service. The criteria for selection included (1) installations with high personnel tempo; (2) installations from different services in the same geographic area for comparison between services; and (3) at least one installation that GAO visited during prior work on predatory lending for comparison across time.<sup>9</sup> Our findings from these site visits cannot be generalized to the population of all military personnel; however, these site visits provided us with additional information for our evaluation. During these site visits, we requested documents (such as training materials) pertaining to DOD’s current efforts to minimize or eliminate the use and effects of predatory lending practices. We conducted individual interviews with seven types of officials at each base: installation leaders, personal financial management program managers, installation finance officials, command financial counselors, legal assistance attorneys, public affairs staff, and military charity organization officials. We used a structured protocol for conducting group discussions with more than 60 senior enlisted personnel at the four installations to gather anecdotal data from servicemembers about their experiences with the types of loans DOD identified as predatory.

**Table 2: Locations Where GAO Conducted a Site Visit**

Service	Location
Army	Fort Lewis, Washington
Navy	Navy Region Southwest, San Diego, California
Marine Corps	Camp Pendleton, California
Air Force	McChord Air Force Base, Washington

Source: GAO.

Part of our assessment of DOD’s report involved a review of the overall report methodology as well as a review of the methodology of key research studies and data sources cited in the report. Specifically, we focused our review on research studies that were critical to the report’s message and the data sources used by DOD. We discussed these data sources with the DOD report authors to gain a better understanding of how and why they were selected for use. At least two internal methods experts, with support from statisticians as appropriate, reviewed these reports and data sources for the reasonableness and rigor of their data collection and analysis methods. Our review focused on the validity of the results and conclusions in relation to how they were used in the DOD report.

We performed our work between March 2007 and August 2007 in accordance with generally accepted government auditing standards.

<sup>9</sup>GAO-05-348 and GAO-05-349.

Enclosure III

**GAO Contact and Staff Acknowledgments**

**GAO Contact:**

Brenda S. Farrell, (202) 512-3604 or [farrellb@gao.gov](mailto:farrellb@gao.gov)

**Acknowledgments:**

In addition to the individual named above, Jack E. Edwards, Assistant Director; Pat L Bohan; Nora Boretti; Renee S. Brown; Cody Goebel; K. Nicole Harms; Ron La Due Lake; Charles W. Perdue; S. Andrew Stavisky; Elizabeth W. Wood; and Yiling Wong made key contributions to this report.

## Related GAO Reports

*Guard and Reserve Personnel: Fiscal, Security, and Human Capital Challenges Should be Considered in Developing a Revised Business Model for the Reserve Component.* GAO-07-984. Washington, D.C.: June 20, 2007.

*Military Personnel: DOD Needs to Establish a Strategy and Improve Transparency over Reserve and National Guard Compensation to Manage Significant Growth in Cost.* GAO-07-828. Washington, D.C.: June 20, 2007.

*Military Personnel: DOD Has Taken Steps to Address Servicemembers' Financial Needs, but Additional Effort is Warranted.* GAO-06-749T. Washington, D.C.: May 18, 2006.

*Financial Product Sales: Actions Needed to Protect Military Members.* GAO-06-245T. Washington, D.C.: November 17, 2005.

*Financial Product Sales: Actions Needed to Better Protect Military Members.* GAO-06-23. Washington, D.C.: November 2, 2005.

*Military Personnel: DOD Needs Better Controls over Supplemental Life Insurance Solicitation Policies Involving Servicemembers.* GAO-05-696. Washington, D.C.: June 29, 2005.

*Military Personnel: DOD's Comments on GAO's Report on More DOD Actions Needed to Address Servicemembers' Personal Financial Management Issues.* GAO-05-638R. Washington D.C.: May 11, 2005.

*Military Personnel: More DOD Actions Needed to Address Servicemembers' Personal Financial Management Issues.* GAO-05-348. Washington, D.C.: April 26, 2005.

*Military Personnel: DOD Tools for Curbing the Use and Effects of Predatory Lending Not Fully Utilized.* GAO-05-349. Washington, D.C.: April 26, 2007.

*Credit Reporting Literacy: Consumers Understood the Basics but Could Benefit from Targeted Educational Efforts.* GAO-05-223. Washington, D.C.: March 16, 2005.

*Highlights of a GAO Forum: The Federal Government's Role in Improving Financial Literacy.* GAO-05-93SP. Washington, D.C.: November 15, 2004.

*Military Personnel: DOD Needs More Data Before It Can Determine if Costly Changes to the Reserve Retirement System Are Warranted.* GAO-04-1005. Washington, D.C.: September 15, 2004.

*Military Pay: Army Reserve Soldiers Mobilized to Active Duty Experienced Significant Pay Problems.* GAO-04-911. Washington, D.C.: August 20, 2004.

*Military Pay: Army Reserve Soldiers Mobilized to Active Duty Experienced Significant Pay Problems.* GAO-04-990T. Washington, D.C.: July 20, 2004.

*Military Personnel: DOD Has Not Implemented the High Deployment Allowance that Could Compensate Servicemembers Deployed Frequently for Short Periods.* GAO-04-805. Washington, D.C.: June 25, 2004.

*Military Personnel: Active Duty Compensation and Its Tax Treatment.* GAO-04-721R. Washington, D.C.: May 7, 2004.

*Military Personnel: Observations Related to Reserve Compensation, Selective Reenlistment Bonuses, and Mail Delivery to Deployed Troops.* GAO-04-582T. Washington, D.C.: March 24, 2004.

*Military Personnel: Bankruptcy Filings among Active Duty Service Members.* GAO-04-465R. Washington, D.C.: February 27, 2004.

*Military Pay: Army National Guard Personnel Mobilized to Active Duty Experienced Significant Pay Problems.* GAO-04-413T. Washington, D.C.: January 28, 2004.

*Military Personnel: DOD Needs More Effective Controls to Better Assess the Progress of the Selective Reenlistment Bonus Program.* GAO-04-86. Washington, D.C.: November 13, 2003.

*Military Pay: Army National Guard Personnel Mobilized to Active Duty Experienced Significant Pay Problems.* GAO-04-89. Washington, D.C.: November 13, 2003.

*Military Personnel: DOD Needs More Data to Address Financial and Health Care Issues Affecting Reservists.* GAO-03-1004. Washington, D.C.: September 10, 2003.

*Military Personnel: DOD Needs to Assess Certain Factors in Determining Whether Hazardous Duty Pay Is Warranted for Duty in the Polar Regions.* GAO-03-554. Washington, D.C.: April 29, 2003.

*Military Personnel: Management and Oversight of Selective Reenlistment Bonus Program Needs Improvement.* GAO-03-149. Washington, D.C.: November 25, 2002.

*Military Personnel: Active Duty Benefits Reflect Changing Demographics, but Opportunities Exist to Improve.* GAO-02-935. Washington, D.C.: September 18, 2002.

(350995)

---

## GAO's Mission

The Government Accountability Office, the audit, evaluation and investigative arm of Congress, exists to support Congress in meeting its constitutional responsibilities and to help improve the performance and accountability of the federal government for the American people. GAO examines the use of public funds; evaluates federal programs and policies; and provides analyses, recommendations, and other assistance to help Congress make informed oversight, policy, and funding decisions. GAO's commitment to good government is reflected in its core values of accountability, integrity, and reliability.

---

## Obtaining Copies of GAO Reports and Testimony

The fastest and easiest way to obtain copies of GAO documents at no cost is through GAO's Web site ([www.gao.gov](http://www.gao.gov)). Each weekday, GAO posts newly released reports, testimony, and correspondence on its Web site. To have GAO e-mail you a list of newly posted products every afternoon, go to [www.gao.gov](http://www.gao.gov) and select "Subscribe to Updates."

---

## Order by Mail or Phone

The first copy of each printed report is free. Additional copies are \$2 each. A check or money order should be made out to the Superintendent of Documents. GAO also accepts VISA and Mastercard. Orders for 100 or more copies mailed to a single address are discounted 25 percent. Orders should be sent to:

U.S. Government Accountability Office  
441 G Street NW, Room LM  
Washington, D.C. 20548

To order by Phone: Voice: (202) 512-6000  
TDD: (202) 512-2537  
Fax: (202) 512-6061

---

## To Report Fraud, Waste, and Abuse in Federal Programs

Contact:

Web site: [www.gao.gov/fraudnet/fraudnet.htm](http://www.gao.gov/fraudnet/fraudnet.htm)

E-mail: [fraudnet@gao.gov](mailto:fraudnet@gao.gov)

Automated answering system: (800) 424-5454 or (202) 512-7470

---

## Congressional Relations

Gloria Jarmon, Managing Director, [JarmonG@gao.gov](mailto:JarmonG@gao.gov) (202) 512-4400  
U.S. Government Accountability Office, 441 G Street NW, Room 7125  
Washington, D.C. 20548

---

## Public Affairs

Susan Becker, Acting Manager, [Beckers@GAO.gov](mailto:Beckers@GAO.gov) (202) 512-4800  
U.S. Government Accountability Office, 441 G Street NW, Room 7149  
Washington, D.C. 20548

---

---

This is a work of the U.S. government and is not subject to copyright protection in the United States. The published product may be reproduced and distributed in its entirety without further permission from GAO. However, because this work may contain copyrighted images or other material, permission from the copyright holder may be necessary if you wish to reproduce this material separately.

---