

PENSION ADVANCES: LEGITIMATE LOANS OR SHADY SCHEMES?

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Chairman Collins, Ranking Member McCaskill, and Members of the Senate Special Committee on Aging, thank you for inviting me to testify today regarding pension advances and to report on recent cases involving Military Pension Assignments where I have been counsel of record on behalf of disabled and retired veterans of our armed forces.

I am the Director of Litigation at the National Consumer Law Center.¹ For the past 16 years I have been responsible for coordinating and litigating cases at NCLC on behalf of income and/or age qualified individuals, primarily in the areas of consumer financing and affordable housing, in state and federal courts throughout the United States. Prior to my work at the National Consumer Law Center, I served as the Chief of the Trial Division and the Business and Labor Protection Bureau of the Massachusetts Attorney General's Office and worked in private practice. I testify here today on behalf of the National Consumer Law Center's low-income and elderly clients. On a daily basis, NCLC provides legal and technical assistance on consumer law issues to legal services, government and private attorneys across the country in order to promote economic justice for all consumers.

I. Military pension scams are stealing income from debt-burdened veterans.

In May, 2003, NCLC was researching consumer scams perpetrated on active military personnel and ultimately issued a report entitled *In Harm's Way-At Home: Consumer Scams and*

¹ The **National Consumer Law Center, Inc.** (NCLC) is a non-profit Massachusetts Corporation, founded in 1969, specializing in low-income consumer issues, with an emphasis on consumer credit. On a daily basis, NCLC provides legal and technical consulting and assistance on consumer law issues to legal services, government, and private attorneys representing low-income consumers across the country. NCLC publishes a series of twenty practice treatises on consumer credit laws, including *Unfair and Deceptive Acts and Practices* (8th Ed., 2012), updated at www.nclc.org/library, and *Cost of Credit: Regulation, Preemption, and Industry Abuses* (4th Ed., 2009), updated at www.nclc.org/library, as well as periodic reports on a range of topics related to consumer credit issues and low-income and elderly consumers. NCLC attorneys have written and advocated extensively on all aspects of consumer law affecting low-income and elderly people, conducted training for thousands of legal services and private attorneys on the law and litigation strategies to deal with predatory lending, unfair debt collection practices and other consumer law problems, and provided extensive oral and written testimony to numerous Congressional committees on these topics. This testimony was written by Stuart T. Rossman, Director of Litigation at NCLC.

*the Direct Targeting of America's Military and Veterans.*² While not the primary focus of this investigation, the report disclosed that the Judge Advocate General Corps felt that some of the greatest abuses they were seeing concerned the solicitation of retired military personnel to gain access to their pension payments.

What NCLC discovered was that companies and individuals were targeting veterans' benefits, usually by offering an up-front cash payment in return for several years of the veteran's monthly benefit, thus creating a growing threat to elder veterans and their dependents. These schemes produced huge profits for the scammers, deprived veterans of funds they needed for their long-term financial security, and, NCLC contended, were illegal.

Veterans receiving retirement and disability benefits are highly attractive targets for financial exploitation:

- Retirement and disability benefit payments are regular, very dependable, and long-term. Furthermore, it is very easy to arrange automatic transfer of the funds each month through "allotments" set up through the Defense Finance and Accounting Service. A company that can convince a veteran to sign over rights to his or her pension payments, and can enforce such an agreement, faces an extremely low risk of non-payment. The companies often reduce this risk even further by requiring the veteran to buy life insurance and designate the company as the beneficiary.
- Veterans are easy to reach through affinity marketing and advertising in targeted publications such as the Military Times Network. Although these publications are produced by a private, for-profit corporation, many service members and veterans perceive them to be "official" and assume that advertisers are screened or approved in

² <https://www.nclc.org/images/pdf/.../report-scams-facing-military.pdf>

some way. The companies may also use the internet, relying upon lead generators, referral networks and commissions to reach more potential victims.³

- Veterans may have, or perceive themselves to have, unusually heavy debt burdens or poor credit as a result of the financial strains of deployment, frequent relocations and other challenges of military service. Veterans, many of whom enlisted at a young age, may also be less familiar with the landscape of legitimate lenders and financial institutions.

A number of companies targeted military veterans by offering lump sums in exchange for the veteran's promise to redirect monthly benefits payments directly to the company for a fixed number of years (8 years is a typical time frame). The cost of these transactions can be astronomically high – NCLC has found agreements with effective APRs of 27% all the way up to 106%. These typically are not small-dollar transactions – the agreements NCLC has examined involved principal amounts that sometimes exceed \$100,000, and on average fall in the range of \$40,000-\$55,000.

The companies try to characterize the transactions as sales or assignments rather than loans for two reasons. First, as the owner of one such company admitted in a deposition, they want to make the transaction non-dischargeable in bankruptcy. Where a true assignment or sale has taken place, the purchaser may have a property interest in the income stream that is unaffected by the bankruptcy; in other words, the obligation effectively cannot be discharged by

³ The then Internet Home Page of Veterans First Financial Services was highlighted in the *Harm's Way* report. The advertisement featured an undulating American flag and, at the top, an eye-grabbing, full-color display of military insignias in motion across the screen. A three-part message flashed over those insignias: "You've worked hard-invest your money the way YOU want—If you're a retired veteran, VFFS, Inc. can help!" A copy of the screen grab from the VFFS website is attached along with a copy of a print advertisement from the November 29, 2004, edition of Air Force Times promoting "Immediate Cash!!! Retired Military Financial Services pays cash now for your military pension. Regular pensions, VA pensions and VSI pensions. Transaction time can be as short as 10 working days. NO upfront fees."

the veteran. Second, the companies seek to avoid disclosure requirements and any usury limits imposed by state law.

II. Henry v. Structured Investments Co. LLC

Darryl Henry's story illustrates the cost of these transactions. Mr. Henry retired as a Chief Petty Officer after 20 years of military service with a combined pension and disability payment of just over \$1,000 per month. Approximately a year and a half later, Mr. Henry began considering purchasing a home for himself and his wife. Mr. Henry tried to comparison shop; he did research on the internet to see what kind of interest rate he could expect to get. Because Mr. Henry already was working to pay off quite a bit of debt, he discovered his credit score was too low to qualify him for the best rates.

Trying to find a better option, he reached out to Retired Military Financial Services which he had seen advertised in the Navy Times (an advertisement similar to the RMFS advertisement attached to this testimony. *See, Fn 2, supra.*). RMFS introduced Mr. Henry to Structured Investments Co. ("SICO") and SICO gave him various estimates of lump-sum payments, based on how much of his pension he signed over. None of the estimates included a disclosure of the effective interest rate. If they had, he would have seen that it was about 28%, far higher than most subprime mortgages and a violation of the California usury laws.

SICO assured Mr. Henry that the transaction was not a loan, and used as a selling point the fact that the transaction would not appear on Mr. Henry's credit report, taking advantage of Mr. Henry's concern about his low credit score. Mr. Henry agreed to direct his entire monthly benefit to the company for 8 years in exchange for a lump sum payment of just over \$40,000. He also paid for a life insurance policy for the benefit of the company. Mr. Henry used the funds he received to pay off his other debts, in hopes that it would improve his credit score, and then he

bought a home with a loan from a conventional lender. Mr. Henry's attempt to be responsible and to improve his credit before buying a house ended up costing him tens of thousands of dollars more than he would have paid if he had not entered into the pension transaction.

Mr. Henry subsequently read a copy of the *In Harm's Way* report and contacted NCLC. NCLC partnered with private attorney Rob Bramson in bringing suit in California Superior Court (Santa Ana, CA, Orange County) on behalf of Mr. Henry and other retired and/or disabled military veterans similarly situated, against SICO and its principals, Ronald Steinberg and Steven P. Covey, individually and d/b/a Retired Military Financial Services.⁴

In his Complaint, Mr. Henry alleged that the defendants engaged in a pattern and practice of entering into transactions with retired and disabled veterans which contain numerous unconscionable and otherwise unenforceable provisions, and which were disguised loan transactions bearing usurious effective interest rates. Furthermore, in connection with such transactions, Mr. Henry alleged that the defendant's documents purported, in effect, to obtain assignments of military pay which were unenforceable in light of the anti-assignment provisions found at 37 U.S.C. §701(c)[assignment of military pension pay of enlisted military personnel upon retirement] and 38 U.S.C. § 5301(a)(1); (3)(A) and (C)[assignment of disability payments for all military veterans regardless of rank].

The Complaint asserted claims that the contracts between the plaintiffs and SICO violated federal law and were void from their inception. The Complaint also claimed that the agreements also were, in substance and effect, usurious loan contracts. Finally, the Complaint claimed that the agreements requiring Plaintiff and class members to assign their military pension and disability pay were expressly prohibited by federal law and, therefore, were unconscionable,

⁴ A copy of the Henry Complaint can be found at http://www.nclc.org/images/pdf/litigation/henry_complaint.pdf

unfair and unlawful violations of the California Unfair Competition Law (“UCL”).

In May, 2011, after certifying a class of plaintiffs, the Superior Court of California, County of Orange, Judge David Velasquez presiding, tried the liability issues in the Henry case. On August 22, 2011, the Judge issued his rulings.⁵

The Court found that “[i]n the present case, the statutes at issue were passed to insure that retired and disabled military personnel actually receive the benefits provide to them from being lost through either the predation of others or their own poor judgement.” Here, “[a]ccording to the Agreements, the pensions never actually reached the class members. Instead, the Agreements provide that a perfected immediate right to possession of the pension and disability payments arises the moment the benefits are deposited in the joint bank accounts, which are completely within SICO’s control.”

Thus, the Court held that “the purposes of the law governing the anti-assignment provisions of 38 U.S.C. § 5301 and 37 U.S.C. § 701 would be thwarted if the court required all of the traditional elements of assignments to be present before calling the transactions assignments.” In light of that conclusion, the court chose “to follow the rule of statutory interpretation that remedial statutes are to be interpreted broadly to protect the purposes for which the law was enacted by the legislature” and, therefore, deemed the SICO agreements, in fact, to be assignments prohibited by federal law.⁶

Because the SICO agreements violated federal law, the Court ruled that “they are unlawful under the unlawful prong of the UCL.” Secondly, “because the defendant SICO used the unlawful Agreements to obtain the class members’ government benefits which the law meant

⁵ A copy of the Henry Decision can be found at <http://www.nclc.org/images/pdf/litigation/Henry.pdf>

⁶ The Court expressly ruled that the Agreements were not loans because the holding that the Agreements were assignments would be inconsistent with a finding that the Agreements were loans.

to protect, and mischaracterized the true nature of the Agreements”, the defendant’s “program” constituted “a sharp practice” and was “unfair with the meaning of the UCL.” Finally, the Court found the defendant’s practice to be “unscrupulous and substantially injurious to consumers in general and to members of the class in particular.”

The Court could find “no lawful utility to SICO’s program of acquiring the pension payment of the class members through the use of its unlawful conduct” and declared the “Agreements to be prohibited and unenforceable.” The Court further found that the plaintiff and the class were entitled to injunctive relief “enjoining SICO, and its agents, employees, officers, directors, and any person or entity working in concert with it from using the Agreements.” Finally, the Court found that the plaintiff and the class were entitled to restitution from SICO in the amount of \$2,927,619.81.

Unfortunately, SICO apparently had no assets available to satisfy the judgment and the company, as well as its principals, subsequently declared for bankruptcy relief. The few class members who had not completed their 8 years of payments had the benefit of stopping the transfer of their pensions, but the rest of the victims (including Mr. Henry) were left to seek recourse in Bankruptcy Court.

III. Conclusion

Court decisions have not been consistent in determining whether Military Pension transactions are loans, assignments, or loans secured by assignments. The transactions should be invalidated as assignments forbidden by federal law, but they also should be subject to usury, Truth in Lending disclosures and other remedies associated with loan statutes.

However, as Mr. Henry’s story illustrates, litigation, even when veterans prevail, is an inadequate response to these abuses. Pro-active, aggressive enforcement is required to prevent

these companies from targeting veterans in the first place. The companies that target veterans for these illegal transactions are elusive; they change names and websites frequently and use nested structures to hide the identities of the individuals involved. A quick search of the internet will disclose that many of these entities continue to prey upon veterans to this day.

NCLC and other consumer advocates remain vigilant. However, government enforcement agencies, like the CFPB, also should continue to use creative, aggressive enforcement tactics, such as working with DFAS to monitor allotments and direct deposit instructions for evidence of new scams, and execute 'stings' on companies that offer illegal military pension products on the internet or through advertisements in affinity publications.