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What you should know about military allotments

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Today, we announced a public enforcement action against U.S. Bank and Dealer's Financial Services (DFS). At issue was the way they used the military discretionary allotment system to have servicemembers pay for cars bought through the MILES (Military Installment Loan and Education Services) Program. It's an important announcement because it shines a spotlight on potential problems with the use of allotments as a way to pay off consumer debt.

The military discretionary allotment system has been around for a long time. When it was first created, there was no such thing as an automatic bank payment or electronic transfer that servicemembers could set up for themselves from a personal bank account. So, the allotment system was very helpful to military personnel who were worried about getting regular payments to their creditors, especially when they were deployed or on the move.

Fast-forward to 2013. We now live in a world where bank account holders can easily arrange for other automatic payment methods, for example by setting up an ACH (Automated Clearing House) payment – where the consumer allows the creditor to pull the money owed each month by using the consumer's bank account and routing numbers – or by asking the bank to send money to a creditor electronically using bill-payment services in online banking. These services are usually free and easy to set up.

So, how does paying by allotment compare to making automatic payments through these newer options?

- **Cost.** Setting up automatic ACH payments using your personal bank account is usually free, while in the case of allotments there may be third-party processors who handle your payment that charge one or more fees.
- **Lack of choice.** Under federal law, a business generally can't require consumers to make payments by automatic electronic payment. But there's an exception to this that leaves out military allotments, so a creditor often can require a servicemember to pay by allotment.
- **Less flexibility** in a financial emergency. With an allotment, the money's paid out by DFAS (Defense Finance and Accounting Services) before your pay gets sent to your bank or credit union, which means you have less flexibility to adjust your budget if a financial emergency comes up.
- **Loss of some legal protections.** With certain exceptions, if an electronic payment that you did not authorize is sent from your bank account, and you notify the bank within 60 days of seeing it on your bank statement, you're not liable for that payment. With an allotment, since it's not coming from your bank account, you don't have that specific protection.
- **Lack of transparency.** In order to process an allotment, lenders sometimes set up a separate bank account in the servicemember's name to receive the payment from DFAS. The servicemember may not understand how this other account works, or that there may be a variety of fees associated with it, including service fees and other fees associated with reclaiming overpayments to the account.

The Secretary of Defense has announced the formation of a working group that will consult with the CFPB and other federal regulators to look at the use of military discretionary allotments. In the meantime, if you go to buy something and are told that you can only pay by allotment, remember what you've read here today and think about walking away from the transaction. What's convenient for the lender may not provide the best protection for you, and reputable lenders will gladly accept payment by other means.