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Proposed changes to the Military Lending Act Regulation
Department of Defense
RIN 0790-AJ10
79 *Federal Register* 58601 (September 29, 2014)

Dear Sir or Madam:

The Associations[1] appreciate the opportunity to comment on the Department of Defense (Department) proposal to amend their regulations that implement the Military Lending Act (MLA). As expressed in our letter on August 1, 2013, responding to the Department of Defense's Advanced Notice of Proposed Rulemaking (ANPR) requesting comment on possible revisions to the MLA regulations, the Associations have worked closely with the Department over the years to ensure appropriate safeguards are in place to protect servicemembers and their spouses and dependents from engaging in specific financial transactions the Department considers harmful, while at the same time avoiding prohibitions that might segregate servicemembers and their spouses and dependents or deny them access to needed and beneficial mainstream credit products. We honor the service and sacrifice made by the members of our armed services and their families and will continue to work collaboratively with the Department to ensure servicemembers as well as their families at all stages of their careers have appropriate access to credit and to the tools and skills necessary to make informed decisions about financial products and services.

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1 ABA represents banks of all sizes and charters and is the voice for the nation's $13 trillion banking industry and its two million employees. The majority of ABA's members are banks with less than $165 million in assets.

The Association of Military Banks of America (AMBA), founded in 1959, is a not for profit association of banks operating on military installations, banks not located on military installations but serving military customers, and military banking facilities designated by the U. S. Treasury. The association's membership includes both community banks and large multinational financial institutions, all of which are insured by the Federal Deposit Insurance Corporation.

The Consumer Bankers Association is the only national financial trade group focused exclusively on retail banking and personal financial services — banking services geared toward consumers and small businesses. As the recognized voice on retail banking issues, CBA provides leadership, education, research, and federal representation for its members. CBA members include the nation's largest bank holding companies as well as regional and super-community banks that collectively hold two-thirds of the total assets of depository institutions.

The Independent Community Bankers of America® (ICBA), the nation's voice for more than 6,500 community banks of all sizes and charter types, is dedicated exclusively to representing the interests of the community banking industry and its membership through effective advocacy, best-in-class education and high-quality products and services. ICBA members operate 24,000 locations nationwide, employ 300,000 Americans and hold $1.3 trillion in assets, $1 trillion in deposits and $800 billion in loans to consumers, small businesses and the agricultural community. For more information, visit www.icba.org.

The National Association of Federal Credit Unions (NAFCU) is the only trade association that exclusively represents federal credit unions.

I. Summary

The MLA authorizes the Department to issue regulations fundamentally to protect servicemembers of all ranks, as well as their spouses and dependents, from certain financial transactions deemed to be predatory. Passed in 2006, the statute was intended to target *specific* loans considered under the legislation to be predatory: payday loans, vehicle title loans, rent-to-own programs, refund anticipation loans, and military installment loans. Consistent with that goal, the Department adopted a regulation that prohibits access by servicemembers and their spouses and dependents to payday or car title loans of short duration with high fees. The express purpose of these requirements is to prevent military households from being trapped in exorbitant short-term debt that would be so onerous as to impose financial hardship on the family, thereby undermining the focus of serving personnel and impairing military readiness.

The Department has proposed a new set of requirements to address two problems that may have developed since the first set of implementing regulations, namely, products designed specifically to evade the earlier regulations falling just outside of the existing product parameters, and the possibility that some covered borrowers are not disclosing their military status to financial service providers. The Department proposes taking two actions:

- Significantly expanding the provisions of MLA to mainstream financial products that are not covered by the original regulations[2] and that, under the proposal, would become off-limits to servicemembers and their spouses and dependents. This expansion would include credit cards, student loans, overdraft lines of credit, personal lines of credit and installment loans, car and other secured refinance loans, and some mortgage loans ("consumer credit").[3]

- Shifting the responsibility to identify their military status from servicemembers and their spouses and dependents to lenders by compelling lenders to screen all applicants to determine their military status or relationship to someone who serves.

The purpose of the MLA as passed was generally accepted and, as initially implemented, was careful to focus narrowly on a set of products not then subject to federal regulation. Today all of these products are subject to the plenary authority of the Bureau of Consumer Financial Protection (Bureau), which is charged with regulating payday and vehicle title lenders, as well as other consumer financial products, for the benefit of all Americans. Where there are improprieties, for servicemembers or for the general population, the Bureau has authority to step in. This change in the financial regulatory landscape points to our concern that the Department needs to take care that additional MLA regulation not fundamentally eliminate individual choice of legitimate and valuable financial products for servicemembers nor preclude servicemembers of all ranks and their privately employed spouses from selecting mainstream financial services available to the public at large. Similarly, in its efforts to address concerns it feels are important for servicemembers, the Department should avoid subjecting the general public to a universal screening process in its desire to ensure that military families are fully covered by the MLA (even where servicemembers wish to avoid that coverage).

Our military and their families make many sacrifices for their service to the country. We believe that the proposed regulations, rather than helping these men and women, would as written, actually work to

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[2] The proposed regulation would include all consumer credit except mortgages (if they are secured by the covered borrower's "dwelling"), car purchase loans, and purchase money loans.

[3] The current regulation covers payday loans, defined as closed-end loans in an amount of $2,000 or less with a term of 91 days or fewer, vehicle title loans, defined as closed-end loans with term of 181 days or fewer secured by title to a motor vehicle, and tax refund anticipation loans.

deny them mainstream financial products and would do so in the absence of a demonstrable adverse impact on our national military readiness. That need not be another sacrifice imposed on them.

We strongly urge the Department to reconsider the breadth and substance of the proposal. We make the following observations and recommendations:

- The regulation should protect military personnel and their spouses and dependents, but it should not deprive them of valuable and beneficial mainstream products or inhibit the availability and development of new products in general– including affordable small-dollar loans.

- The proposal is not a cap on the rate of interest, but in fact is a new "military annual percentage rate" (MAPR) cap.[4] Unlike the credit cost measurements of Regulation Z, which implements the Truth in Lending Act, and state usury laws, the complicated new military annual percentage rate calculation inflates and distorts the cost of credit. The 36 percent MAPR cap captures a broad swath of consumer credit including credit cards and small-dollar affordable loans. It captures, for example, even a credit card with a 0 percent interest rate.[5]

- The proposal prohibits certain other terms, including vague but key terms the proposed regulation does not define, and it fails to recognize the significant impact the prohibition of those terms will have on the ability of depository institutions to provide a compliant consumer loan to servicemembers and their spouses and dependents.

- The proposal's prohibition against pre-dispute arbitration agreements means that servicemembers and their spouses and dependents may lose that option as a means to resolve any dispute. This fair and typically quicker alternative to litigation is particularly convenient to servicemembers who are deployed away from their civilian home or abroad, where they lack access to courts.

- The proposed regulation presents risks and costs for all depository institutions, even if they were able to ensure that their products comply with the regulation.

- If the regulation is expanded as proposed, the greatly increased volume of inquiries to the Department's database, which today is frequently unavailable, will cause consumer credit lending to come to a halt when the database is unavailable.

- The Department should expand coverage as needed to address efforts at evasion, but in a targeted fashion, consistent with the history and intent of the legislation. It should exempt depository institutions from the regulation, including the MAPR component, to ensure military personnel and their spouses and dependents continue to have access to mainstream products. The Department has not identified any data or support to show that products offered by depository institutions, including credit cards, have the characteristics of the predatory loans Congress and the Department intended to target or that they are the source of problems for

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[4] The Department at times refers to the MAPR cap as an "interest-rate limit," but that characteristic is misleading as in fact the MAPR includes costs other than interest. *See* 79 FR 58624 (September 29, 2014).

[5] A card with a promotional rate of 0 percent would not meet the MAPR cap, for example, if it charged a modest \$5 transaction fee for a \$100 cash advance. Under the regulation the \$5 fee in theory might be excluded from the MAPR calculation if the fee were proved to be "bona fide." However, as discussed later, that standard is unworkable and unusable.

military personnel and their spouses and dependents. Moreover, depository institutions are regularly *examined* for compliance with consumer protection laws, and banking agencies have exhibited their willingness and aggressiveness in addressing depository institution products they believe may be harmful to consumers, particularly military customers.

- The Department grossly underestimates the costs of the proposal. It underestimates not only the costs of the minimum and limited cost factors it has identified, but it also overlooks significant expenses associated with other provisions of the proposal that the Department has claimed will have a minimal cost impact. By overlooking many of the products that the proposal covers, it misses the cost implications and compliance complications for all depository institutions of all sizes.

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II. Broad Highlights

1. Protection of servicemembers, their continued access to mainstream credit, and continued development of financial products

The regulation should protect military personnel and their spouses and dependents but not deprive them of valuable and beneficial mainstream products or inhibit the availability and development of new products generally—including affordable small-dollar loans.

Most military personnel and their spouses and dependents manage their finances well and use and value mainstream depository institution consumer credit products, as the FINRA Investor Education Foundation found in its 2012 study.[6] However, some among this group may face financial challenges, including challenges in managing budgets, coping with emergencies, and managing credit.[7] It is important that the regulation protect those servicemembers, their spouses, and dependents against predatory loans as the MLA intended.

Equally important, as the Department has repeatedly stated, is that the regulation not eliminate the choices of their comrades who use credit responsibly nor cause *all* servicemembers and their spouses and dependents to lose access to valuable mainstream loan products. "Consistent with the Department's longstanding policy in administering 10 U.S.C. 987, the Department intends to develop this regulation so that its provisions are true to the intent of the MLA without creating a system that unduly impedes the availability of credit that is beneficial to servicemembers or is so burdensome that the creditor cannot comply."[8] Other Department statements reinforce this goal. [9] The Associations agree that access to credit is critical, but we fear that the regulation will mean that covered products, which

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6 "The results of the Defense Manpower Data Center ("DMDC") QuickCompass on Financial Issues tends to indicate that most Service members report sufficient access to safe, low-cost credit, report few problems managing their finances, and report little use of or impact by high-cost credit products on their financial lives." *See* 79 FR 58605 (September 29, 2014).
"The study portrays a military community that in the aggregate is relatively strong in financial capability. See FINRA, "Financial Capability in the United States—2012 Report of Military Findings," December 2013. p. 1.
"Overall, 66% consulted a financial professional (outside of the military) over the past 5 years. The most frequent topics are insurance and savings/investment." *See Ibid.,* p. 12. "Among males 18 to 35, military respondents are less likely to use nonbank borrowing." The report also found that this group is "more likely than the national average to have home debt, credit card debt, and student debt, and are twice as likely to have an auto loan." *See Ibid.,* p. 31. The greater incidence of home and car loans and ownerships suggests they have greater financial sophistication and credit eligibility. The greater incidence of student loans suggests they have higher education. Credit card debt suggests many are avoiding nonbank credit alternatives such as payday loans.

7 "Nevertheless, the DMDC survey results also tend to indicate that a substantial minority of Service members continue to report difficulty managing their finances, and little access to safe, low-cost credit options." *See* 79 FR 58604 (September 29, 2014).

8 *Ibid.,* p. 58622.

9 "Isolating detrimental credit products without impeding the availability of favorable installment loans was of central concern in developing the regulation." "The Department's intent is to balance protections with access to credit. The protections posed in the statute assist Service members, when applied with precision, to preclude unintended barriers." *See* 72 FR 50582 (August 31, 2007*).* "[T]he Department has learned of the potential for unintended consequences that could adversely affect credit availability if it were to adopt a broadly applicable regulation." *See Ibid.,* p. 50584. **"The intent of the statute is clearly to restrict or limit credit practices that have a negative impact on Service members without impeding the availability of credit that is benign or beneficial to Service members and their families."** (Emphasis added.) *See Ibid.,* p. 50584. The Department implemented the narrow definitions of credit and consumer "judiciously, having heard from numerous groups. . . that applying the provision broadly would create numerous unintended consequences. These unintended consequences would have a chilling effect on the availability of consumer credit for Service members and their dependents in circumstances that are not necessarily predatory." *See Ibid.,* p. 50584*.*

will include many mainstream products (including popular and valuable credit cards), will be legally off-limits for military personnel and their spouses and dependents, as the Department recognizes.[10] Depository institutions' products are important complements to those of the military relief societies. They encourage development of real-world financial skills not only while in service, but also prepare servicemembers for life after service has ended.

We also have concerns about the broader implications, not only for military personnel and their spouses and dependents, but for the general population, as the regulation will limit the types of products and features depository institutions may offer, chill innovation, stifle improvement, reduce availability of desirable products, limit competition, and eliminate consumer choice. If adopted as proposed, the regulation is likely to lead to consumer-unfriendly cookie-cutter products.

People who are having or have had difficulty with finances will feel the impact most. In particular, the proposal will significantly exacerbate the already difficult challenge depository institutions have in offering affordable small-dollar loans, thwarting efforts by the Department, as well as banking regulators, including the Bureau, to encourage depository institutions to offer small-dollar affordable loans.[11] The banking agencies, as well as the Bureau, consider such products from depository institutions to be critical tools to move users of alternative nonbank credit products, including military personnel and their spouses and dependents, into bank and credit union loan products and away from those nonbank loans. As discussed in more detail later, small-dollar loan products offered by some banks, including those praised by the Department itself, as well as those modeled on the National Credit Union Administration's "Payday Alternative Loan" program, will not comply with the regulation, in particular the 36 percent MAPR cap. Banks and credit unions offering such products may be unable to provide them to military personnel and their spouses and dependents – or have to abandon them altogether. The regulation will add one more complication to the challenges of developing such products that will discourage other institutions from offering them. The proposed restrictions on secured credit offered by depository institutions will also eliminate an important path that helps people with little or negative credit history to build or rebuild a credit history that will help them qualify for other credit, including mortgages and car loans.

2. Exemption for depository institutions to ensure servicemember access to mainstream credit

If the Regulation were to expand coverage, it should do so in a targeted fashion, and should clearly exempt depository institutions from the regulation, including the MAPR component, to ensure military personnel and their spouses and dependents continue to have access to mainstream products. The Department has not identified any data or support to show that products offered by depository institutions, including credit cards, are the source of problems for military personnel and their spouses and dependents or that the regulation should be expanded to cover those products.

We understand that the Department wants to close loopholes and cover predatory products intentionally designed to circumvent the restrictions. We agree with and support that purpose of the Department and want to work with the Department to address any problems. However, without any supporting data, the current proposal reaches far beyond the predatory products and abuses Congress'

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[10] "The Department understands creditors may otherwise decline offering beneficial credit products to covered borrowers as a result of concerns over potential violations." *See* 72 FR 50588 (August 31, 2007).

[11] As discussed later, any fixed fee easily will cause the MAPR to exceed the cap, especially for small-dollar loans. The MAPR cap, coupled with the other prohibitions in the proposal as well as other regulatory requirements for small-dollar loans and economic practicalities will discourage the availability of affordable small-dollar loans.

intended target and what the Department is attempting to reach, as indicated in its June 17, 2013, ANPR and the supplementary information to its proposal. In a striking departure from the goal and purpose of the statute, of the existing regulation, and of the representations in the ANPR, the proposal expands application from the specific types of loans the statute and regulation targeted to capture the vast majority of mainstream consumer credit products. This includes those offered by depository institutions of all sizes.

To be clear***, the proposal is not a 36 percent usury cap,*** a figure that few, if any, depository institution products would exceed. Rather, the regulation imposes a new, unique, and sometimes retro-actively calculated MAPR that can cause even a small, routine fee to result in a highly inflated figure that far exceeds an annualized 36 percent, which in turn quickly captures many mainstream products, including credit cards with low interest rates and fees.[12] Secured credit cards, which can be useful to help consumers establish credit or recover from past credit issues, are generally prohibited under the proposal. Also seriously problematic and often overlooked are the other vague and very uncertain prohibitions related to legal notices and waivers that make it impossible for a lender to know whether it is in compliance. Thus, coverage presents serious challenges, which may not be surmountable, to ensure compliance for depository institution consumer credit. Indeed, it was these concerns that led the Department to apply a narrowly focused regulation in 2007 which, as discussed later, has been successful in addressing many of the issues around predatory loans targeted at servicemembers.

For these reasons, rather than capturing virtually all non-mortgage, non-purchase money consumer credit, we recommend a more focused approach and urge the Department to address particular problems of the current regulation by modifying coverage in a targeted fashion, consistent with its previous approach. Specifically, ***we recommend that the Department broaden coverage of the regulation by eliminating the current parameters in the definition of covered consumer credit related to loan terms and amount, expand coverage to open-end credit, and exempt insured depository institutions because:***

- Military personnel and their spouses and dependents may lose access to needed, valuable, and popular mainstream depository institution credit products, including credit cards, overdraft lines of credit, loans to refinance their car at a lower rate, and personal, unsecured loans;

- The clear intent of the legislation was to protect military personnel and their spouses and dependents from specific, identified predatory loans—payday loans, car title loans, military installment loans, rent-to-own programs, and tax refund anticipation loans,[13] which are products primarily offered by non-depository financial institutions;

- There is no evidence or data that depository institution products such as credit cards, overdraft lines of credit, personal lines of credit and installment loans, private student loans, auto and similar refinance loans, certain mortgages not covered by the mortgage exemption, and other covered loans are creating hardships unique to servicemembers and their spouses and dependents; and

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12 As discussed in detail later, while the proposal attempts to exempt certain "bona fide" fees for credit cards under certain circumstances, the exemption in the proposal is not usable. The standard is too vague and subject to interpretation as to make compliance very uncertain and expensive litigation and enforcement actions very likely. Thus, it is simply unworkable and therefore available in name only.

13 Department of Defense, "Report On Predatory Lending Practices Directed at Members of the Armed Forces and Their Dependents" (August 9, 2006), p. 2.

- Unlike nonbank lenders, all depository institutions are regularly examined for compliance with consumer protection laws. In addition, bank and credit union regulators have demonstrated their willingness to address proactively and aggressively perceived consumer harm related to bank and credit union products.

3. Imposition of costs and risks to all depository institutions

The proposed regulation presents risks and costs for all depository institutions, even if they were able to ensure that their products comply with the regulation.

In general, the proposal presents significant risks, challenges, and costs for *all* depository institutions, particularly community banks and small credit unions. They are *all* subject to the compliance complications and burdens, the heightened litigation risks, especially in light of the subjectivity and uncertainty of the meaning of key terms, and the draconian penalties for violations, even technical ones. Small depository institutions, in particular, will have to determine whether to take the risk of attempting to design compliant products and continuing to offer consumer credit such as credit cards, overdraft lines of credit, personal installment loans and lines of credit, student loans, car and boat refinance loans, secured credit cards, mortgage loans not covered by the mortgage loan exemption, and any other covered loans. The additional compliance costs to continue offering those products will be reflected in the price that borrowers pay.

If depository institutions continue to offer such products, hoping that they comply with all of the requirements of the regulation, *at a minimum*, they must identify military personnel and their spouses and dependents in order to provide them the required oral disclosures mandated by the statute. The proposal indicates that lenders may identify covered borrowers—which would be required for *every* consumer credit application—by accessing the Department's MLA database[14] of active military personnel and their spouses and dependents. Reliance on the Department's MLA database *appears* to offer a "safe harbor," but the safe harbor does not apply if the institution otherwise has documentation or a record of the customer's active military status. Thus, to ensure compliance, this means all banks and credit unions must develop an internal database to capture and centralize all records and documents that might indicate a customer is a servicemember or spouse or dependent of a servicemember. In addition, the internal system, as well as the Department's MLA database, must be widely accessible and available to ensure relevant bank and credit union personnel have real-time access to both databases.

Whether the depository institution decides to *attempt* to create "plain vanilla" products that conform to the regulation, thus limiting choices and new features for all consumers, or restrict military personnel and their spouses and dependents to products they hope but cannot be sure are compliant, they take on significant exposure. Indeed, these challenges prompted the Department to adopt a narrowly tailored regulation in 2007. The proposal undermines those earlier efforts by reversing course and broadly applying the regulation, pulling in problems that the 2007 regulation sought to avoid.

The vagueness and uncertainty of key terms in the regulation, as well as the prohibition against mandatory arbitration, will attract potentially costly and meritless nuisance lawsuits. Such suits are unrelated to the enforcement of the regulation or protection of military personnel and their spouses

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[14] The Department makes available to the public two databases containing information about military status, the Servicemembers Civil Relief Act (SCRA) database to determine military status for purposes of eligibility under the SCRA, and the MLA database, designed to identify borrowers covered by the MLA. Both databases receive information from the Department's Defense Enrollment Eligibility Reporting System (DEERS), the designated automated information system holding information on those eligible for benefits, entitlement, identification cards, and Common Access Cards. DEERS is maintained by the Defense Manpower Data Center.

and dependents and simply exploit the ambiguity and vagueness of the regulation. Also attracting such meritless suits and increasing potential liability is the statutory provision that a violation of Regulation Z for a product covered by the MLA is also a violation of the MLA (which means military families are accorded greater remedies for the same violation as might be experienced by all other users of the product.) Thus, a lender who makes an error in Regulation Z is subject not only to the significant penalties for that regulation but also the extreme penalties of MLA. The inability to comply with certainty, even adopting the most conservative approach, the vagueness of key terms in the regulation, and the additional liability for Regulation Z violations will create enormous litigation risks with all the associated burdens for depository institutions that continue to lend to military personnel and their spouses and dependents.

The safer and more rational alternative for creditors and borrowers may be to develop appropriate and effective means to identify covered borrowers and advise them that they are not eligible for certain products.[15] This is precisely the purpose behind the MLA—to render identified financial transactions, or credit with particular features, off-limits to members of the military and their dependents. Indeed, the Department has recognized denying credit as a natural outcome of the regulation, noting in its discussion about credit cards that "some creditors might elect to stop offering these products altogether or suspend certain functions of the card."[16] To avoid this outcome and so that depository institutions can continue to provide valuable, beneficial products to military personnel and their spouses and dependents, the proposal should exempt depository institutions from all provisions of the regulation.

4. Issues with the Department's MLA database

If the regulation is expanded as proposed, the greatly increased volume of inquiries to the Department's database, which today is frequently unavailable, will cause consumer credit lending to come to a halt when access to the database is unavailable.

The proposal presents many practical issues, especially the reliability of the Department's MLA database on which banks and credit unions will have to rely for compliance. The current challenges related to the reliability of the Department's Servicemembers Civil Relief Act (SCRA) database will be exacerbated with the significant increase in the volume of inquiries the Department will have to manage if the proposal is adopted, since virtually every consumer loan for any consumer will need to be checked against the database. Moreover, lenders most likely will have to make a minimum of two inquiries for each loan application, at the time of application and again when the loan closes, because coverage is based on the status of the borrower *at the time* the borrower becomes obligated or establishes an account. Furthermore, the volume of inquiries to the database will increase if lenders regularly check the database to monitor when borrowers are no longer active military, become divorced, or are otherwise separated from or a dependent of the servicemember, etc., and therefore no longer eligible for special treatment. The Department will be moving from managing a very small percentage of inquiries limited to self-identified military personnel (excluding spouses and dependents) to maintaining and ensuring the reliability of real-time access to a database that includes not only military personnel but also their spouses and dependents and that is capable of responding to inquiries for virtually every covered consumer credit application in the country on virtually any day and at any time– at a minimum.

Moreover, when the database is unavailable, which already is not uncommon with the Department's more limited SCRA database, as illustrated in the screen shots inserted below, the impact

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15 However, in states with nondiscrimination laws protecting military personnel, depository institutions may not be able to comply with one regulation without violating the other.

16 70 FR 58611 (September 29, 2014).

is not limited to military personnel and their spouses and dependents: depository institutions will not be able to approve any covered credit for *any* consumer until the database is again available to give the institution the green light to proceed. When the Department's database is unavailable, that means that virtually all new consumer lending comes to a standstill. To illustrate, a person (military or civilian) wishing to open a store credit line to finance the purchase of a needed refrigerator or to benefit from a special discount offer will be unable to do so if the Department's database (or the lender's internal database) is unavailable. The loan opportunity is blocked, as will be the sale for the merchant, and the customer is frustrated in a way ranging from a nuisance to a potentially serious personal predicament.

III. Background and History of MLA, Regulation and Proposed Revisions

On October 17, 2006, Congress passed the "John Warner National Defense Authorization Act of Fiscal Year 2007." That act included MLA, which was intended to remedy abusive practices associated with payday lending and certain other specific predatory loans to military personnel, as identified in the Department's earlier August 2006 study, "Report on Predatory Lending Practices Directed at Members of the Armed Forces and Their Dependents," (Department of Defense Report). The original payday lending amendment, which was added to the bill on the Senate floor, was narrower than the legislation ultimately passed by Congress. In essence, the Senate floor amendment capped interest on loans to military personnel and their spouses and dependents. In conference, however, the Senate amendment was significantly expanded in an effort to address *specific concerns* related to predatory lending contained in the Department of Defense Report. There was little public debate, no hearings, and no input from the Congressional committees with jurisdiction over financial products, the banking industry, or banking regulators. As a result, the potential for unintended consequences was not considered or vetted.

Among the provisions of the MLA are restrictions against using direct debit to repay a loan, prohibitions against refinancing a loan the lender originally made, limitations on "interest" rates (as defined by the regulation implementing the MLA to include more than interest), requirements to provide oral disclosures, and prohibitions against waivers of "right to legal recourse," mandatory arbitration, and imposition of "onerous" or "unreasonable" legal notices.

Penalties for violations of the MLA are severe: lenders may be imprisoned for willful violations; the loan is void from inception (which would require identifying and refunding fees and interest paid by the borrower); lenders may be liable for actual damages (but not less than $500) as well as punitive damages, attorney's fees, court costs, and are subject to equitable or declaratory relief and other relief provided by law. In addition, violations of Regulation Z, which implements the Truth in Lending Act, constitute violations of the MLA. In January 2013, Congress amended the statute to allow private rights of action to be brought in federal court.

In adopting its regulation in 2007, as Congress did when it passed the statute, the Department focused on its 2006 Department of Defense Report and discussed that report's description of predatory lending that the statute was intended to address:

> Predatory lending in the small loan market is generally considered to include one or more of the following characteristics: High interest rates and fees; little or no responsible underwriting; loan flipping or repeat renewals that ensure profit without significantly paying down principal; loan packing with high cost ancillary products whose cost is not included in computing interest rates; a loan structure or terms that transform these loans into the equivalent of highly secured transactions; fraud or deception; waiver of meaningful legal redress; or operation outside of state usury or small loan

protection laws or regulations. The effect of other practices include whether the loan terms or practices listed above strip earnings or savings from the borrower; place the borrowers' key assets at undue risk; do not help the borrower resolve their financial shortfall; trap the borrower in a cycle of debt; and leave the borrower in worse financial shape than when they initially contacted the lender.[17]

The Department also discussed at length the five specific products identified in the Department of Defense's Report as problematic: payday loans, vehicle-title loans, rent-to-own, refund anticipation loans, and military installment loans. These were the products that had been "identified by installation-level financial counselors . . . and legal assistance attorneys who regularly counsel service members on indebtedness issues."[18] The Department concluded, "cycle of debt represents a more significant concern to the Department than the high cost of credit." It also noted, "the regulation has focused on credit products that have, in general practice, terms that can be detrimental to military borrowers," [19] citing as an example installment loans with favorable terms that can increase the interest rate well beyond the limits prescribed by 10 U.S.C 987. The Department stated its goal of ensuring continued access by military personnel, their spouses and dependents to mainstream products: "isolating detrimental credit products without impeding the availability of favorable installment loans was of central concern in developing the regulation."[20] "These unintended consequences would have a 'chilling effect' on the availability of consumer credit for Service members and their dependents in circumstances that are not necessarily predatory."[21] Given the focus of its report, the intent of Congress, and the goal to make predatory products unavailable to military personnel, their spouses and dependents but ensure for those borrowers continued access to mainstream, beneficial products, the Department excluded from the regulation products such as credit cards, overdraft lines of credit, most personal installment loans, personal lines of credit, student loans, and other loans such as car and similar refinance loans.[22] The final regulation underscores the Department's recognition of the serious compliance issues and the goal to avoid the unintended consequences, which include the inability of the protected military class to access mainstream credit products.

On June 17, 2013, the Department published a one-page ANPR,[23] requesting comments on whether the Department should consider revising existing protection under the regulation. The focus of the Department's ANPR discussion clearly was *predatory* loans, specifically, vehicle title loans and payday loans, and their impact on military personnel, their spouses and dependents, as its reference to the legislative history of the 2013 amendments demonstrate. There was no hint that the Department was considering the vast and broad expansion of the current proposal and wholesale re-writing of the rule. The ANPR made a general reference to expansion of coverage, but in the clear context of the specific predatory loans listed above. There is no mention of credit cards or other bank and credit union credit products or any suggestions of concern or evidence that those products were harming military personnel or their spouses or dependents.

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17 72 FR 50581 (August 31, 2007).

18 *Ibid.,* p. 50581.

19 *Ibid.,* p. 50582.

20 *Ibid.,* p. 50582.

21 *Ibid.,* p. 50584.

22 The final regulation limited application to "payday loans" defined as closed end loans not exceeding $2,000 with a term of 91 days or fewer, "vehicle title loans," defined as closed-end loans with a term of 181 days or fewer secured by title to a motor vehicle (other than a purchase money transaction), and "tax refund anticipation loans" defined as closed-end credit in which the borrower grants the creditor the right to receive all or part of the borrower's income tax refund or agrees to repay the loan with the proceeds of the borrower's refund. Open-end credit, such as credit cards, were exempt.

23 78 FR 36134 (June 17, 2013).

The Associations submitted extensive comments to that request, citing the report from the Consumer Federation of America (CFA), as discussed later, that the current rules have been successful and are working as intended. Our letter stressed the need to protect servicemembers and their spouses and dependents but also avoid separate rules that segregate and limit their access to mainstream, beneficial products from depository institutions.

In the current proposal, published September 29, 2014, the Department restates its intent to develop a regulation "true to the intent of the MLA without creating a system that unduly impedes the availability of credit that is beneficial to Service members or is so burdensome that the creditor cannot comply."[24] More importantly, as discussed later, with regard to expansion of the proposal, the comments the Department cites are focused on payday loans, title loans, rent-to-own plans, installment loans targeted at military personnel, and tax refund anticipation loans. None focus on credit offered by depository institutions or credit cards."[25] Indeed, the Department states that it continues to believe that certain "*payday loans, vehicle title loans, and refund anticipation loans present the most severe risk* to Service members and their families, and remains mindful that more broadly defining the 'consumer credit' that would be subject to 10 U.S.C. 987 may present unintended consequences, including a reduction in 'credit availability." (Emphasis added.)[26]

IV. Summary of Proposal

1. Coverage

Under the proposal, the Department would expand the definition of covered "consumer credit" from its current definition to capture, in effect, nearly all consumer credit. The few exceptions would be the following:

- A residential mortgage, defined as any credit transaction secured by an interest in the covered borrower's dwelling, including a transaction to finance the purchase or initial construction of a dwelling, any refinance transaction, home equity loan, line of credit, or reverse mortgage;
- Any credit expressly intended to finance the purchase of a motor vehicle when the credit is secured by the property being purchased;
- Any credit transactions expressly intended to finance the purchase of personal property when the credit is secured by the property being purchased; and
- Certain classes of loans exempt from Regulation Z per state request.

Thus, the proposal covers, among other financial products:

- Credit cards;
- Student loans;

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24 79 FR 58622 (September 29, 2014).

25 The Department sites a single reference to "overdraft loans," which was part of a series among other predatory nonbank products, but the term was undefined and the reference provided no further information or detail, including any data or even an example of any harm to military personnel and their spouses and dependents.

26 79 FR 58607 (September 29, 2014).

- Overdraft lines of credit;
- Personal installment loans;
- Personal lines of credit;
- Loans to refinance cars and other personal property, for example, to lower the interest rate;
- Mortgages for real estate not yet containing a “dwelling,” (“lot loans”); and
- Mortgages that are secured by residential property not owned by the servicemember, spouse or dependent of the servicemember.

2. Limitations on covered loans

Loans covered by the proposal are subject to the following:

- ***MAPR cap of annualized 36 percent:*** The MAPR, as defined, may not exceed an annualized 36 percent. MAPR is different from “interest” or the annual percentage rate “APR” calculation of Regulation Z, which implements the Truth in Lending Act. The MAPR includes:
    - Finance charges;
    - Any fee for participation in any plan (such as an annual fee for credit card);
    - Any application fee;
    - Credit insurance premiums; and
    - Fees, related to ancillary products sold “in connection with and either at or before consummation of the credit transaction for closed-end credit or upon account opening for open-end credit.”

  For open-end credit, the calculation must be made retro-actively based on the actual account activity for the period. In months where there is no balance, no fees may be charged except a participation fee that does not exceed $100, regardless of the cycle in which it is imposed. The $100 limitation does not apply to credit cards if the issuer can show that the fee is “bona-fide.”

  For credit cards only, bona fide fees that are reasonable *and* customary may be excluded from the MAPR calculation (except for credit insurance premiums and fees for credit-related ancillary products). For a bona fide fee to be reasonable and customary, it must be compared to fees “typically imposed by other creditors for the same or substantially similar product or service.” A bona fide fee is “reasonable” if it is less than or equal to an average amount of a fee for “the same or a substantially similar product or service” charged by 5 or more creditors each with at least $3 billion in outstanding loans on U.S. credit card accounts at any time during the 3-year period preceding the time such average is computed. A fee higher than such an average may be reasonable “depending on other factors relating to the credit card account.” If a creditor imposes *any* fee that is not a bona fide fee and imposes a finance charge, the total amount of those fees, *including* any bona fide fees and other finance charges, shall be included in the MAPR.

- ***Limitations on refinancing covered loans:*** Refinancing of covered loans is restricted. Depository institutions are exempt from this provision.

- ***Prohibition against waiving right to legal recourse:*** Lenders may not require borrowers to waive the covered borrowers' right to legal recourse under any otherwise applicable provision of State or Federal law, including any provision of the SCRA. "Right to legal recourse" is undefined, and no examples are provided.

- ***Prohibition against arbitration or other onerous legal notice in the case of a dispute:*** Lenders may not require covered borrowers to submit to arbitration or impose "other onerous legal notice provisions in the case of a dispute." "Other onerous legal notice provisions in the case of a dispute" is undefined, and no examples are provided.

- ***Prohibition against unreasonable notice as a condition for legal action***: Lenders may not demand "unreasonable notice from the covered borrower as a condition for legal action." "Unreasonable notice from the covered borrower as a condition for legal action" is not defined, and no examples are provided.

- ***Prohibition against secured credit and access to bank accounts:*** Lenders may not use a check "or other method of access to a deposit, savings, or other financial account of the covered borrower," except that if the MAPR does not exceed 36%, the lender may require an electronic fund transfer to repay the loan, require direct deposit of the "consumer's" salary as a condition of eligibility for consumer credit, and may take a security interest in an account, but *only if* the funds are "deposited after extension of credit in an account established in connection with the consumer credit transaction." Thus, it appears that secured credit cards relying on an existing account or a deposit made at the time of the account opening as security, for example, would not be permitted, regardless of the MAPR.

- ***Prohibition against requiring establishment of allotment to repay loan:*** Lenders may not as a condition for extension of consumer credit require that the covered borrower establish an allotment to repay the obligation.[27]

3. Oral and written disclosures

With respect to all covered consumer credit, all depository institutions must provide to military personnel and their spouses and dependents certain oral and written disclosures "before or at the time the borrower becomes obligated on the transaction or establishes an account." In addition to the Regulation Z disclosures required under the proposal (which under Regulation Z must be provided in writing), the following disclosures must be made *both orally and in writing*:

- A statement of the applicable MAPR, which may be satisfied by describing the charges the credit may impose. It does not require disclosure of the numerical value of the MAPR. Lenders may rely on the 108-word model language.

- A description of the payment obligation, i.e., a payment schedule for closed-end credit or the Regulation Z account opening disclosures for closed-end credit.

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[27] At the end of November, the Department announced additional restrictions on the use of allotments by servicemembers (http://www.gpo.gov/fdsys/pkg/FR-2014-11-28/pdf/2014-28104.pdf). Anecdotal evidence suggests that few, if any, depository institutions rely on allotments for repayment of credit.

- A notice of 111 words explaining that federal law provides protections for active servicemembers and their dependents and they may be able to obtain financial assistance from military sources and free legal advice and counseling regarding consumer credit.

4. Identification of covered borrowers

Under the proposal, servicemembers and their spouses and dependents are no longer responsible for disclosing their military status to lenders. Lenders may no longer rely on the statements from applicants about their military status. Instead, lenders must themselves make a determination about whether the applicant is covered. The proposal allows lenders to rely on the Department's MLA database as a safe harbor if they maintain a record of the information obtained *unless* they have "actual" knowledge that an applicant is covered. A lender has actual knowledge if it has any record (including any electronic record) collected by the lender prior to the transaction and maintained in any system used by the lender that relates to the consumer credit involving that consumer. Information from the Department's MLA database is deemed conclusive so long as the creditor maintains a record of the information obtained.

Penalties for violations

- ***Criminal penalties***: Creditors knowingly violating the regulation are subject to fines and imprisonment for up to one year.

- ***Voidance of the contract***: Any agreement is void from inception of the contract if any provision is violated.

- ***Arbitration:*** No agreement to arbitrate any dispute involving the extension of covered consumer credit to a covered borrower is enforceable against any covered borrower or any person who was a covered borrower when the agreement was made.

- ***Private right of action and civil liability:*** A person who violates the regulation is liable to any actual damage, but not less than $500 for each violation, punitive damages, appropriate equitable or declaratory relief, and any other relief provided by law.[28]

- ***Costs of the action:*** Those found to violate the regulation are liable for the costs of the action and reasonable attorney fees.

- ***Regulation Z violation:*** A violation of Regulation Z involving any product covered by the regulation is also a violation of the MLA.

V. Lack of Data to Support Broad Expansion

While data may support a tailored modification of MLA coverage, there are no data or evidence to support the proposed broad expansion to depository institution consumer credit products. Nor do those products have the characteristics of the predatory loans Congress and the Department intended to target. Therefore, to ensure that access to credit is not restricted or impaired, depository institution products should be exempt.

[28] The MLA was amended in January 2013 to add a private right of action in federal court.

As noted above, the focus of the statute, and what the Department of Defense's Report identified as most troublesome, were predatory practices, specifically those associated with payday loans, tax refund anticipation loans, and car title loans. To that extent, as we stated in our August 1, 2013, letter, the regulation has been relatively effective in protecting members of the armed services as it was intended. Indeed, according to a study by the Consumer Federation of America (CFA) the current regulations have been successful and are working as intended. The CFA study found: "To the extent products met these definitions, the law has been largely effective in curbing predatory payday, car title, and tax refund lending to covered borrowers"; "[T]he impact of the federal law prohibiting certain payday and car title loan products is very pronounced;"[29] "Payday loans provided from brick and mortar outlets appear to no longer be widely available to servicemembers…"[30] Tax refund anticipation loans have been virtually eliminated.[31] This is consistent with the DMDC QuickCompass on Financial Issues survey, which found that only "2% said they had used payday loans in the past 12 months and 4% said they used vehicle title loans."[32]

That being said, there appears to be evidence that there exist online payday loans and other loans designed to circumvent the regulation's definition of covered loans (e.g., payday loans that exceed the 91-day term and $2,000 loan amount parameters of the regulation's definition of consumer credit).[33] However, there is no evidence that these products are being offered by depository institutions. Equally, there is no evidence or analysis to support coverage of depository institution products, including credit cards, based on the goals and intent of Congress when it passed MLA or based on any of the predatory characteristics outlined by the Department in its report or its discussion of the final regulation adopted in August 2007, as outlined in the earlier section on the background and history of MLA. Finally, while the many financial products offered by depository institutions provide demonstrably clear benefits to military personnel and their dependents, there is no data to show that such products are harming them.

As explained above, the history of the MLA makes clear that in implementing the regulation the Department, relying on Congressional intent and its own report on which the statute was based, analyzed the characteristics of predatory practices in order to identify the types of loans the regulation was intended to cover: high interest rates and fees; little or no responsible underwriting; loan flipping or repeat renewals that ensure profit without significantly paying down principal; loan packing with high cost ancillary products whose cost is not included in computing interest rates; a loan structure or terms that transform these loans into the equivalent of highly secured transactions; fraud or deception; waiver of meaningful legal redress; or operation outside of state usury or small loan protection laws or regulations. We do not believe that credit cards or the other depository institution consumer credit meet these criteria.

1. Credit card regulations, supervision, and characteristics

Credit cards are offered not only by the largest institutions but by thousands of small and mid-sized credit unions and banks. According to the bank and credit union call reports, 4,940 banks and credit

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29 Jean Ann Fox, "The Military Lending Act Five Years Later—Impact On Servicemembers, the High-Cost Small-dollar Loan Market, and the Campaign against Predatory Lending, Consumer Federation of America," May 2012, p. 9.

30 *Ibid.,* p. 9, 23. However, the CFA found that military borrowers "are still encountering" payday loans online and at some stores.

31 *Ibid.*

32 Department of Defense, "Report: Enhancement of Protections on Consumer Credit for Members of the Armed Forces and Their Dependents" (August 2014), p. 20.

33 Jean Ann Fox, "The Military Lending Act Five Years Later—Impact On Servicemembers, the High-Cost Small-dollar Loan Market, and the Campaign against Predatory Lending, Consumer Federation of America," May 2012, p. 25.

unions issue credit cards.[34] The Federal Reserve Board of Minneapolis found in a recent survey that 80 percent of credit unions, 59 percent of banks, and 76 percent of all depository institutions offer credit cards.[35]

Credit cards are subject to federal consumer protection laws specific to credit cards, including the CARD Act and the Truth in Lending Act, and are closely scrutinized by the Bureau and banking regulators. Indeed, since enactment of the MLA, Congress has given the Bureau plenary authority to regulate consumer financial products, including credit cards, to guard against predatory practices or terms. Moreover, credit cards lack the characteristics identified by the Department as "predatory," which is the focus and concern of the MLA and the Department.

The Department noted in the supplementary information to the proposal that it "believes that credit card products may warrant special consideration under the MLA because comparable protections for consumers who use these products separately apply under the Credit Card Accountability Responsibility and Disclosure Act of 2009 ('CARD Act')."[36] The CARD Act, as a practical matter, eliminated any adverse characteristics of predatory loans that might have been ascribed to credit cards. In fact, that act went further to provide additional consumer protections that assist borrowers in understanding and managing their credit well. Among other provisions, the CARD Act—

- Prohibits additional fees (other than penalty fees) for the credit line if fees exceed 25 percent of the total credit line in the first year;

- Caps late fees, payment return fees, and over the limit fees to $25 for the first occurrence and $35 for reoccurrences within six months (subject to inflation increases);

- Requires issuers to demonstrate an applicant's ability to repay (including an "independent ability to repay" for those under 21 years of age) before offering a credit card account;

- Prohibits increases on interest rates on outstanding balances and requires advance notice of higher interest rates to be applied to new transactions;

- Prohibits a rate increase in rates, fees, or finance charges in the first year;

- Requires promotional rates to extend at least six months (unless limited exceptions apply);

- Requires that issuers consider such factors when later considering rate reductions if interest rate is increased based on certain factors;

- Requires on the first page of the billing statement a highlighted warning about only paying the minimum, the number of months to pay and total cost if cardholder only pays the minimum and there are no further advances, the monthly payment amount to pay the balance over 36 months, the savings if the borrower pays within 36 months, and a telephone number about credit counseling;

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34 *See* bank call reports at https://www2.fdic.gov/Call_TFR_Rpts/ and credit union call reports at http://www.ncua.gov/DataApps/QCallRptData/Pages/default.aspx

35 Federal Reserve Bank of Minneapolis Payments Information and Outreach Office, "2014 Payments Fraud Survey Summary of Regional Results," p. 11.

36 79 FR 58611 (September 29, 2014).

- Requires cardholders to opt in for approval of transactions that exceed the credit limit;
- Prohibits the repayment term from changing except if it allows a five-year amortization, the minimum is not more than doubled, or the method is no less beneficial;
- Requires billing statements to be provided 21 days prior to the due date;
- Requires the due date to be the same each month;
- Requires the due date and amount of late fee to be listed prominently together on the billing statement; and
- Prohibits imposing fees for payment, regardless of the method of payment.

Though Congress created these broad consumer protections when it passed the CARD Act in 2009, what it did not do was expand application of MLA to credit cards, even though they were exempt from MLA at that time. If Congress had felt it necessary to apply MLA to credit cards, it could and would have done so in 2009.

Apart from the CARD Act, the Truth in Lending Act, as implemented under Regulation Z, has specific disclosure requirements for credit cards and requires that important terms, including interest and fees, be highlighted. That regulation—

- Requires that a summary of key credit card terms be highlighted in a special table with large fonts in all applications, solicitations, and billing statements using similar, mandatory terminology;
- Imposes similar requirements to change-in-terms notices;
- Requires that cardholders receive an easy-to-read summary of their agreement, also with specific formatting, heading, and font requirements, after the account is opened; and
- Requires on billing statements that interest and fees be grouped together and highlighted, in a box with a special heading with a summary of each by billing period and year to date.

These requirements designed so that consumers understand the cost of credit cards before they enter into an agreement; that they have easy-to-understand summaries of their agreements for understanding and reference; and that they get billing statements that highlight interest charges, fees, and what they are paying for credit, as well as information to assist them in managing their credit, such as the minimum payment notice. The provisions also assist cardholders in paying on time by requiring a consistent due date and requiring that the due date and consequences of late payments are highlighted.

Furthermore, other characteristics the Department identified as predatory, and described earlier, i.e., loan flipping or repeat renewal, characteristics that transform the card into a highly secured transaction, and waivers of meaningful legal redress, simply do not apply to credit cards. Any concerns about fraud or deception may be addressed by the Bureau, created after the MLA was enacted in order to address such issues for consumer financial products and all consumers. Equally, the Bureau has the authority—and has exercised that authority—to address issues with credit card products.[37] Credit card

[37] Between July 2012 and April 2014, the Bureau has taken action against no fewer than seven large credit card companies, ordering them to pay millions of dollars in restitution and penalties for various credit card practices.

and other depository institution products may be exempt from state usury provisions, but credit card interest rates are not exempt from market pressures and are very competitive.

Unlike predatory loans, credit cards provide flexible terms that put the customer in control with regard to access to the credit and timing of repayment. Cardholders have the ability to use only as much credit as they need, which avoids paying unnecessary interest. Access is convenient, which is critical in emergencies, especially for servicemembers serving abroad and their families remaining at home. The payment schedule gives borrowers the ability to pay balances off in full whenever they wish and are able or to pay off over time, if that is more manageable for their budget and individual circumstances. Other guidance issued by the OCC, FDIC, and Federal Reserve Board, regarding the work down of principal via minimum payments emphasize that issuers must "carefully consider the repayment capacity of borrowers."[38] Moreover, as noted, credit cards and their terms are highly competitive, with low rates available for eligible borrowers. In addition, and very important, credit cards offer highly valued features that go far beyond credit. These include rewards (including cash-back rewards), car rental insurance, warranties on purchases, travel and airline perks (such as free baggage transit, access to airline lounges, and priority seating/boarding), and concierge services (restaurants, hotels, tickets to sports and other event), to name a few. While high fees might apply to these high value products, that is because credit is only one aspect of the product.

2. Regulation and supervision of the other depository institution loan products

Beyond credit cards, many other credit products provided by depository institutions of all sizes, such as personal loans (both lines of credit and installment loans), overdraft lines of credit, student loans, car and other personal property refinance loans, and covered mortgage products simply do not meet any of the listed criteria for identifying predatory practices (high interest rates and fees; little or no underwriting; loan flipping or repeat renewals that ensure profit without significantly paying down principal; high cost ancillary products; a loan structure or terms that transform the loans into the equivalent of highly secured transactions; fraud or deception; waiver of meaningful legal redress; or operation outside of state usury or small loan protection laws or regulations). As noted, any issues relating to fraud and deception can and will be addressed by the Bureau, which was created after passage of MLA to focus on financial protection for all consumers, as well as by the banking agencies. Furthermore, unlike other creditors, insured depository institutions are subject to regular examinations and oversight that carefully review compliance with consumer protection regulations.

3. Lack of data or support to expand application of regulation to depository institution products

Not only do depository institution products, including credit cards, lack the predatory characteristics on which the Department based coverage of the MLA, we have been unable to identify any data,

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[38] "The Agencies expect lenders to require minimum payments that will amortize the current balance over a reasonable period of time, consistent with the unsecured, consumer-oriented nature of the underlying debt and the borrower's documented creditworthiness. Prolonged negative amortization, inappropriate fees, and other practices that inordinately compound or protract consumer debt and disguise portfolio performance and quality raise safety and soundness concerns and are subject to examiner criticism." *See* OCC, Federal Reserve Board, FDIC, OTS, "Credit Card Lending: Account Management and Loss Allowance Guidance. p.3. "Credit line assignments should be managed conservatively using proven credit criteria. The Agencies expect institutions to test, analyze, and document line-assignment and line-increase criteria prior to broad implementation. Support for credit line management should include documentation and analysis of decision factors such as repayment history, risk score, behavior scores, or other relevant criteria. *See Ibid.,* p. 2.

including any identified by the Department, to support expansion of the MLA regulation to credit cards and other depository institution loan products. In addition, a review of the 37 letters submitted to the Department in response to its June 2013 ANPR provides no support to subject credit cards and other depository institution products to the regulation.

CFA's Report and comment letter (submitted by the CFA and other consumer activists—CFA letter) of August 1, 2013, provided extensive information and data about the use of payday loans, vehicle title loans, and tax refund anticipation loans by military personnel and their spouses and dependents. It provided no data or evidence that any depository institution products were posing harm to military personnel and their spouses and dependents. The report recommended coverage of certain bank "deposit advance products."[39] *However, neither they nor the few other commenters who referenced these products provided any data or evidence that these popular and valued products were high-cost, "predatory," inadequately underwritten, or even a problem for users. Nor did they present evidence that they were being used by military personnel and their spouses and dependents let alone presenting a problem for them.* Indeed, banks who previously offered them reported that the only complaints they received about these products were from customers who were upset that they could not get a loan, because they had reached the bank's consecutive use limits. The Department did not mention deposit advance loans in the supplementary information to the proposal, but its April 2014 report found that only 3 percent of enlisted servicemembers used bank advances in the prior 12 months. Moreover, although that report provides no information about the fees paid, it found that the average number of months respondents had used bank advance loans was 3.6 months and the median seven months,[40] indicating that servicemembers were not falling into a cycle of debt or a debt trap in using these products. *In any case, the few banks offering those products have in effect abandoned them following FDIC and OCC guidance adopted in 2013.* The exception is one bank that has significantly modified its product.

The CFA letter also recommended expansion of the regulation to cover credit cards but offered no data or evidence to support the expansion. In their August 1, 2013 letter, after acknowledging that the CARD Act addressed many issues related to credit cards, the commenters only speculated that service members "*may*…be harmed by credit cards that carry high rates, include numerous costly fees, and may lead to billing disputes or complaints about collection practices."[41] (Emphasis added.) The letter concludes that because CFA and others continue to have some concerns about the fees of a very small minority of credit cards (a fee structure the CARD Act specifically addressed by limiting fees in the first year, as discussed above), *all* credit cards should be covered. It is equally striking that the letter contains no recommendations, let alone evidence, that other depository institution products, including overdraft lines of credit, personal loans and lines of credit (with the exception of the now largely abandoned deposit advance product), student loans, car and similar refinance loans, and certain other mortgage loans should be covered, as proposed.

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39 Deposit advance products, which were previously offered by about six banks, allowed advances limited to the lesser of a cap (typically $500) or a percentage of the average recurring payment (e.g. 50 percent). Programs usually charged a fee based on the amount advanced (e.g., $7.50 per $100 borrowed), and the credit was usually repaid automatically from a recurring direct deposit, such as payroll. Programs typically included protections to prevent a cycle of debt, such as limitations on consecutive use. Because the loans amounts were small and the terms far shorter than a year, the fees could produce a relatively high *annual* percentage rate. However, the annual percentage rate is not a true measure of a loan that is far shorter than a year.

40 Department of Defense, "Report: Enhancement of Protections on Consumer Credit for Members of the Armed Forces and Their Dependents" (August 2014) p. 28.

41 CFA comment letter, p. 9.

Similarly, a letter from consumer activist organizations,[42] though their complaints were heavily focused on non-depository loans, also briefly referenced credit cards and recommended covering them on the basis that credit card rates and other fees "can be very high," and although the CARD Act has been beneficial, "the potential for abuse remains*."* A letter from the Shriver Center and one from a group of organizations, using identical language to the CFA letter, also recommended such coverage. They also offered no data in support, merely speculation.

In general, the commenters who recommended expansion of coverage focused heavily on "high-priced" loans with little or no underwriting and specifically on nonbank payday loans, auto title loans, and, to a lesser extent, tax refund anticipation loans. Their concerns were around the proliferation of payday and auto title loans that in their view were structured with longer terms merely to evade the MLA's requirements.

Indeed, the Department's focus in the background material provided in the supplementary information to the proposal is exclusively on "predatory" practices and specific loans: payday loans, title loans, rent-to-own plans, installment loans targeted at military personnel, and tax refund anticipation loans. None of the comments to the ANPR that the Department cites in the supplementary information to this proposal concern credit cards or credit offered by depository institutions.[43] Following are specific comments the Department cited:

- One commenter was "'particularly concerned with [a] multiple-payment or installment loan'" that is not covered by the rule, "'because the loan has a term of over 91 days or exceeds $2,000." This commenter stated, more specifically, that '[i]n Texas, high cost multiple-payment loans with rates often exceeding [600 percent] APR are increasingly offered by *payday lenders*." (Emphasis added.) The commenter followed with a reference to *payday lenders*.[44]

- One commenter discussed concerns about lenders who "circumvented the purpose and protections intended by the MLA" – and then provided the example of the "*payday loan* law in Colorado." (Emphasis added.)[45]

- One person commenting that the current rule has loopholes, specifically cited *payday loans, title loans, overdraft loans, and sales credit loans or other similar rent-to own transactions.* There is no mention of credit cards, or other bank products other than the unclear reference to "overdraft loans."

- One commenter urged "the Department to include within the scope of the rule '*payday and vehicle title loans of any duration*, whether open or closed-ended,' '*tax refund anticipation loans of any duration*,' as well as to 'consider extending the 36 [percent] APR cap to unsecured *installment loans targeted at the military* and all other forms of consumer credit.'"[46] (Emphasis added.)

- One commenter expressed concern that one out of every ten veterans reported having more than $40,000 in unsecured debt…often from *high-cost lenders that frequently target military*

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[42] Signatory list begins with Virginia Poverty Law Center.

[43] The Bureau cites a single reference to "overdraft loans," which was part of a series among other predatory nonbank products, but the term was undefined, and the reference provided no further information or detail, including any data or even an example of any harm to military personnel and their spouses and dependents.

[44] 79 FR 58607 (September 29, 2014)

[45] *Ibid.,* p. 58508.

[46] *Ibid.*

bases." The commenter noted that the current rule "'does not apply to all forms of *payday* lending permitted under state law" and recommended aligning with Regulation Z. (Emphasis added.)[47]

- One commenter wrote that the "Department should 'not lose sight of [a] *payday lender's demonstrated capacity for creative evasion,'*" that some "lenders disguise short-term loans as check cashing services and others disguise loans and loan fees using the sale of phone cards or other 'trinkets' at inflated prices combined with the delayed presentment of checks." The commenter suggested "*rent-to-own transactions* should be included as consumer credit" together with "*all payday, rent-to-own, installment, and vehicle title loans* without respect to the duration of the loan."[48] (Emphasis added.)

It would be a great leap to conclude that these commenters were suggesting application to "all" consumer credit, rather than all payday and similar loans etc., especially as they did not specify any other types of loans beyond those loans, or otherwise indicate that they understood or recognized the breadth of the meaning of "consumer credit," as defined by Regulation Z.[49] Indeed, "consumer credit" under Regulation Z includes mortgages and car purchase loans, but those commenters did not indicate that they believed it necessary to extend coverage to those loans or that they understood that they were exempt from MLA, further evidence that their focus was on the expansion of payday and similar loans, not to the array of loans offered by depository institutions, including credit cards and small-dollar affordable loans.

A recent letter from members of the Senate supporting the proposed expansion similarly focuses on "predatory and high cost lending," "evolving predatory lending practices targeting service members and their families," "use of predatory marketing practices, and other abuses," "high-cost debt," and the need to prevent "future evasions." In discussing support for the expansion and the need to prevent evasion, the letter specifically refers to the ability to avoid the regulation "by simply adding a day to the term of a payday loan or by lending just one additional cent so that the payday loan no longer qualifies as 'consumer credit' subject to the MLA protections." Clearly, the reference point of the letter is the evasion of the regulation by non-depository institutions and the need to capture those loans designed to avoid the regulation—not mainstream depository institution products, including credit cards and affordable small-dollar loans. Significantly, the letter makes no mention of the depository institution products being an issue.[50] In addition, the letter's support of MLA regulation consistency with the requirements of the Truth in Lending Act (TILA) cannot have meant support for consistency in the definitions of consumer credit, because, as discussed below, the MLA and TILA themselves are not consistent in the products they cover. TILA covers mortgage and purchase money loans like car loans. The MLA specifically exempts those consumer credit products. Moreover, as mentioned, since passage

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47 *Ibid.*, p. 58509.

48 *Ibid.*

49 The Department in its April 2014 report appeared to make the highly questionable leap that all the comments recommending expansion clearly were intended to include all consumer credit, including credit cards and other depository institution loans. *See* Department of Defense, "Report: Enhancement of Protections on Consumer Credit for Members of the Armed Forces and Their Dependents" (August 2014), at 34-35.
However, the Department did not mention that reference in the supplementary information to the proposal, and such a leap is not consistent with the content and context of the comments. As discussed, none mentioned depository institution consumer credit. Only three mentioned credit cards but provided no evidence that credit cards presented harm to military personnel and their spouses and dependents.

50 November 25th letter to Department of Defense Secretary Hagel from U.S. Senators Dick Durbin and Jack Reed et al.

of the MLA, Congress passed the CARD Act, which addressed issues related to credit cards. Significantly, it did not apply MLA or MLA-type provisions to credit cards at that time.

Moreover, as already noted, the Department itself very recently stated that it "continues to believe that certain *payday loans, vehicle title loans, and refund anticipation loans present the most severe risk* to Service members and their families, and remains mindful that more broadly defining the 'consumer credit' that would be subject to 10 U.S.C. 987 may present unintended consequences, including a reduction in 'credit availability.'" (Emphasis added.)[51]

The Department did not mention, in the supplementary information to the proposal, reasons or support for expanding coverage to include credit cards and other depository institution products. Notably, its earlier report on enhancements of protections on consumer credit discusses credit cards and servicemembers, but only in the context of the servicemembers' understanding of their credit card price and their credit card use and habits. The report provides no support to conclude credit cards are high-priced or that issuers target military personnel and their spouses and dependents with ill-suited or ill-advised products. While the Department may view having credit card debt—or any debt—as "negative," the statute does not authorize the Department to prohibit military borrowers and their spouses and dependents from having any debt. Nor is debt elimination for military personnel and their spouses and dependents the purpose or goal of the statute.

We also add that the Department's one-page ANPR of June 17, 2013, contained no hint that Congress or the Department envisioned or anticipated broadly expanding coverage. The focus of the discussion in the ANPR, including its references to Congressional reports, was clearly on *predatory* loans, very specifically vehicle title loans, payday loans, and their impact on military personnel, their spouses and dependents. Indeed, the ANPR cited the Conference Report accompanying H.R. 4310, "National Defense Authorization Act for Fiscal Year 2013," which amended MLA, that the Senate amendment would amend section 987 [MLA] to require that *vehicle title loans and payday loans, regardless of duration or whether they are open-or closed-end, are included within the definition of 'consumer credit'* contained in the regulation…." (Emphasis added.) The ANPR further cited the Conference Report's reference to concern about a report that found "many *predatory lenders* have modified their products to avoid coverage by the Department's rules…" (Emphasis added.) The ANPR made a general reference asking for comment on whether to expand coverage, but in the context cited above—with regard to those specific predatory loans. It made no mention of credit cards or other bank and credit union credit products or any suggestions of concern or evidence that those depository institution products were harming military personnel or their spouses and dependents.

While the Department made a brief reference to a joint comment letter from the signatories of this letter in the supplementary information, it made little or no reference to the letters from organizations representing lenders or to their comments expressed in those letters. Letters were also submitted by the American Financial Services Association, the National Association of Federal Credit Unions (a separate letter in addition to the joint letter), the Credit Union National Association, OMNI Financial, the Missouri Credit Union Association, the Ohio Credit Union League, the Michigan Credit Union League & Affiliates, Desert Schools Federal Credit Union, Georgia Credit Union Affiliates, National Installment Lenders Association, and Online Lenders Alliance. Letters from these groups cited the data, including CFA's Report, showing that the MLA was largely successful. They expressed their concern that wholesale broad coverage will harm military personnel and their spouses and dependents by depriving them of access to fair and appropriate credit for servicemembers and their families" and recommended against a broad expansion. Some specifically recommended an exemption for credit unions and banks to ensure

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51 79 FR 58607 (September 29, 2014).

the continued availability of mainstream, beneficial products to military personnel and their spouses and families. The supplementary information to the proposal made only a passing reference to these concerns.

Supporting the argument that the broad coverage proposed lacks basis, a review of the complaints the Bureau received from servicemembers, veterans, and their families indicates that credit cards work well for military personnel, veterans, and their families and that these customers need and want them. Over the course of two and a half years (July 21, 2011 through February 1, 2014), the Bureau received 14,100 complaints from military consumers. Of that total, only about 12 percent (1,700) related to credit cards.[52] This number is low given that most military personnel, 91 percent, have a credit card,[53] that the Bureau does not verify the accuracy of the complaints, and that the "military consumers" category also includes complaints from veterans who are retired military.

Moreover, the vast majority of the credit card complaints were unrelated to interest or to fees or practices the proposed regulation would seek to address. The category representing the highest percentage (14 percent, representing about 238 complaints) of credit card complaints identified "billing disputes"[54] which are usually related to disputes with the merchant where cardholders, dissatisfied with the product or performance of a merchant, may use the credit card as a convenient channel to try to resolve the dispute. The Bureau noted that some of the military personnel complaining were frustrated, because they did not realize that to dispute a claim they need to notify their credit card company within 60 days of the error (pursuant to Section 1016.13(b) of Regulation Z). The other examples of credit card complaints the Bureau offered were that "consumers are not aware that companies typically do not stop a merchant charge once the cardholder has authorized it or do not override a merchant's 'no-return' policy."[55]

Only about eight percent of the credit card complaints (136) filed in that two and a half year period related to interest rates of which the details are unknown.[56] However, a similar number, seven percent, representing 119 of the complaints, related to complaints that an account was closed or cancelled, demonstrating the impact and potential concern of military personnel and their spouses and dependents if they were to lose or have limited access to credit cards. The Bureau received 68 complaints (representing 4 percent of the total complaints) about late fees. However, the proposal does not impact those fees. That a higher percentage of military personnel have a credit card than the general population also demonstrates the importance of their continued access to credit cards.

The Department explains that a reason for its proposed expansion to cover all "consumer credit" is to facilitate compliance by making the meaning of the term "consumer credit" consistent with that term under the Truth in Lending Act.[57] The proposal does not make the terms consistent nor ease compliance.

First, the terms are *not* consistent, because the Truth in Lending Act includes mortgages and car purchase loans, which are rather large segments of "consumer credit" from the perspective of consumers and compliance officers, which the MLA does not cover. Moreover, that the types of loans covered under MLA consist of one subset of the Truth in Lending Act coverage rather than another subset does not ease compliance. Any subset of the Truth in Lending Act covered credit will create a compliance burden simply because it is different from the Truth in Lending Act. However, the larger the

52 CFPB, "Complaints received from servicemembers, veterans, and their families," March 2014, p.9.
53 FINRA, "Financial Capability in the United States-2012 Report of Military Findings," December 2013, p. 14.
54 CFPB, "Complaints received from servicemembers, veterans, and their families," March 2014, p.10.
55 *Ibid.,* p. 9.
56 CFPB "Complaints received from servicemembers, veterans, and their families," March 2014, p. 10.
57 79 FR 58603 (September 29, 2014).

subset, (which is proposed) the stronger the compliance headaches. Thus, from the depository institution perspective, the breadth of the proposal rather than any perceived consistency with the Truth in Lending Act is clearly a source of the compliance burden and risk.

Second, the Department strives for consistency in the definition of consumer credit but then seems to miss the area where consistency makes the most sense, whether for consumers, covered borrowers, or compliance officers: the measurement of the cost of credit. The Truth in Lending Act and Regulation Z already have a well-established, well-understood, embedded term to measure credit, the APR, which has been in place for *decades.* The Department is now introducing a third, very distinct, inconsistent, confusing, unworkable, and misleading credit measurement, the MAPR, as discussed in more depth below. Military personnel and their spouses and dependents will be confused, whether or not MAPR is disclosed, because fees may be waived in one month but not the next, in an unpredictable fashion.[58] Compliance officers and technical staff will have to understand the difference between APR and MAPR and test the MAPR just to be able to know whether their products exceed the limit. They will have to develop separate systems, special and continuing training, and special disclosures. Simply put, while appreciated, the Department's concerns about compliance burdens are misplaced.

4. Justification of exemption for depository institutions

Strong supervisory oversight supports depository institution exemption.

It is noteworthy that the Department in 2007 considered exempting depository institutions from the regulation but determined it unnecessary, because the definition of consumer credit in the final regulation did not include products from those institutions. The Department stated at the time, that it had "determined that given the limited types of credit products covered by the rule, an exemption for depository institutions is not needed to ensure access to benefit credit by Service members and their dependents." It noted that, "Federally-supervised financial institutions that commented appeared to be concerned about the future iterations of the regulation and the potential for the regulation to impact their ability to provide beneficial credit to Service members and their families," concluding, "*If the Department considers it necessary to reconsider the products included as covered consumer credit, the issue of such exemptions would also be reconsidered.*" (Emphasis added)[59]

The time has come for the Department to apply an exemption for depository institutions in light of its true targeted interest in products specialized in by non-depository institutions and in view of the recent legislative and regulatory enhancement of consumer protection oversight and regulation of depository institutions. While nonbank lenders are subject to Bureau supervision, and the Bureau has powerful authority for nearly all lenders, most nonbank lenders are not examined on a regular basis. In contrast, all depository institutions are subject to regular examination by prudential examiners (and in the case of large depository institutions, also by the Bureau) for compliance with all financial consumer protection laws.

The Bureau on its own, however, does not have the ability to intervene on the basis of "safety and soundness" as prudential regulators do, and those prudential regulators have demonstrated their willingness to exercise those authorities. The recent "Guidance on Supervisory Concerns and Expectations Regarding Deposit Advance Products of the OCC and the FDIC (Banking Agencies) released

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[58] As explained later, the MAPR will vary depending on the cardholder's activity and choices, because it is based on various factors, including the balance, amount of the fee, and timing of transaction and payment.

[59] 72 FR 50584 (August 31, 2007).

in November 2013 clearly illustrates that policy and the Agencies' standard for intervention in this regard.[60]

VI. Analysis of Specific Substantive Provisions

An analysis of the proposal demonstrates its flaws, compliance and practical problems, and its unintended consequences, which are harmful to military personnel and their spouses and dependents, as well as to all consumers.

As discussed, the need for the proposal to expand the scope of the regulation to include credit cards and other depository institution products is unsupported by data or complaints. However, the consequences will be profound for military personnel and their spouses and dependents, as well as for the general population. The proposal will capture most mainstream consumer credit, including low-interest loans, and will impose on them significant requirements and prohibitions. The severity of the sanctions for violations—which is impossible to overstate—coupled with the likelihood of misinterpreting—or being accused of misinterpreting—vague provisions of the regulation makes lending to military personnel and their spouses and dependents risky from a regulatory point of view.

Credit unions and banks will be left with a draconian choice: (1) not making covered consumer credit available to military personnel and their spouses and dependents; (2) attempting to design products so they do not run afoul of the regulation and taking the significant risk of a potential violation and liability under the harsh penalties for violation; or (3) abandoning those products entirely, reducing consumer choice and competition and discouraging the development of small-dollar affordable loans. The following discussion illustrates the complexities, challenges, and flaws of the proposal to demonstrate the unintended consequences.

1. Identification of covered borrowers and problems with MLA databases

The requirement for lenders to query the Department's database for each consumer credit loan will overtax an already unreliable system and inconvenience all consumer credit applicants. In addition, it will impose significant costs on all depository institutions, especially small institutions, related to the necessary changes to operating systems, security, procedures, and staff training, and the continuing costs associated with compliance monitoring and examination. We believe that the Department has grossly underestimated the cost and volume of inquiries the proposal will require. Moreover, it offers little evidence that military personnel and their spouses and dependents are being untruthful on applications, the basis for shifting the responsibility for determining military status from the borrower to the lender.

As stated earlier, the proposal effectively requires *all* depository institutions that offer *any* consumer credit, to take actions to identify possible covered borrowers. That is because it is not immediately obvious to banks which of their customers are covered. Currently, bankers may rely on the customers' statements that they are or are not covered. The proposal shifts this responsibility to depository institutions. The only way that a depository institution can ensure compliance is to inquire with the Department's MLA database, for every single customer.

The proposal provides as a safe harbor that a creditor "may conclusively determine whether credit is offered or extended to a covered borrower…by assessing the status of a consumer" by accessing the Department's MLA database. Creditors technically may elect a different method, but the option is

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60 FDIC, OCC, "Guidance on Supervisory Concerns and Expectations Regarding Deposit Advance Products."

meaningless as a practical matter. We do not know what "other" methods might be available or accessible, and the proposal offers none, but any other method is subject to costly challenge and potential and significant liability if there is an error. Given the lack of viable options, the potential liability, the regulatory and compliance culture of credit unions and banks, and the potential for examiner criticism and "suggestions," depository institutions have no choice but to use the safe harbor. This means that depository institutions will have to design systems and procedures to ensure that they have real-time access when making loans. In addition, they have to design systems and procedures to ensure that they capture evidence of the inquiry and results.

Adding to the complexity and challenges of the identification requirement is the loss of the safe harbor if the database is incorrect and the lender has "actual" knowledge that a consumer is covered. "Actual" knowledge potentially may be established on the basis of any record collected by the creditor prior to entering into a transaction and maintained "in any systems used by the creditor" that relate to the consumer credit involving that consumer. To be prudent and ensure compliance and avoid the severe consequences of a violation and examiner criticism, all credit unions and banks would have to create an independent internal system to capture and centralize any documentation that might suggest that the customer is in the service or the spouse or dependent of a servicemember. This could include, for example, a change of address notice or the copy of a military identification card that might be in the file.

Thus, depository institutions would have to have systems and procedures to ensure that relevant personnel have real-time access to both the Department's MLA database as well as their own database for every covered consumer loan. In addition, they must have a process and system to retain a record of the results of the Department database query. Even without extensive investigation, we know that this will be a *huge* task to develop and implement for *all* depository institutions, regardless of size, in terms of integrating systems, capturing proof of military status determination, training staff, and ensuring that the systems is available during any period when the institution is processing and approving loans. We cannot at this time offer a projected timetable, but such an endeavor would need significant time to develop, test, adjust, and re-test. It would also disrupt IT schedules, a costly and risky consequence, especially due to the numerous new regulations depository institutions are currently implementing and those they expect to implement in the next year or two.

In addition to these complications, the proposal presents significant practical problems. Under Section 232.2 of the proposal, the regulation would apply if the consumer is covered "at the time he or she becomes obligated on a credit transaction or establishes an account for credit." Most lenders, for practical and compliance reasons, at a minimum will need to access the database at the time of application and *again* when the loan closes, as coverage is based on the customer's status at the time the agreement is actually made. This necessity for multiple inquiries is contrary to the Department's assumption of "single record checks."[61]

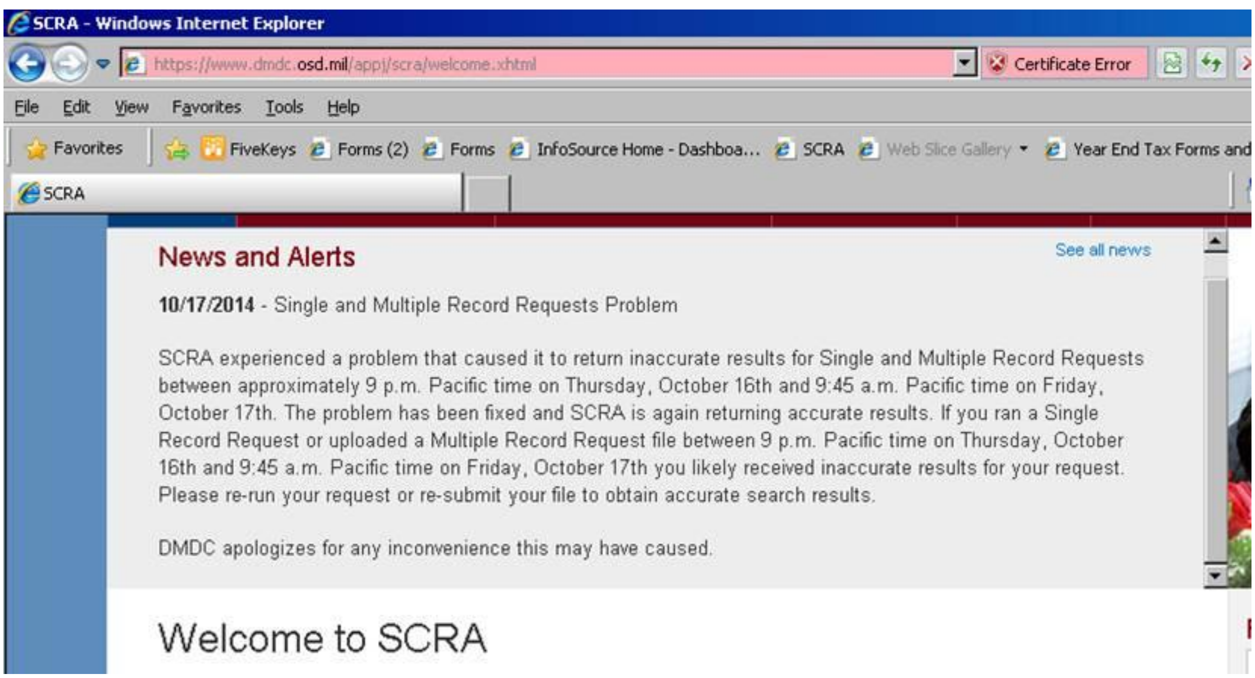
Moreover, a depository institution will have to query the database multiple times with regard to open-end credit, such as credit cards. Consumers typically do not become "obligated" on credit cards, for example, until the first transaction or a certain period after delivery of the card, as recognized under Section 1026.5.(b)(1) of Regulation Z. We do not know how lenders will be able to verify the customer's status at this time as they have no control over when the customer decides to "accept" the account. They may have to make inquiries periodically. Inquiries would also be required when a credit card account is "upgraded" because, under Regulation Z, it is a "new account." In addition, for open-end

[61] 79 FR 58630 (September 29, 2014).

credit such as credit cards, lenders will need to access the database on a regular basis to ascertain the customer's *continued* eligibility for special treatment.

Beyond the huge and impractical project the proposal creates for all depository institutions in order to identify a small percentage of customers, the lack of reliability of the Department's current SCRA database suggests that the requirement to identify military personnel and their spouses and dependents has a realistic potential to bring consumer lending to a halt on frequent occasions. As discussed, depository institutions cannot proceed with opening a consumer credit account unless they determine—and document—the customer's military status. However, if the MLA database is not available, any person wishing to open a store credit card account to finance a needed refrigerator or other purchase, for example, will have to be denied the credit, whether or not the person is a covered borrower, since the lender will be unable to verify the customer's status at that time. *All* applicants, regardless of military status, will be unable to have any consumer credit loan approved until the system is running again, which might be days, based on recent experience as illustrated below.

The SCRA database is frequently unavailable and, in fact, has itself reported that it has been inaccurate. For example, as shown in the screenshot below, on October 17, 2014, the SCRA database reported, "SCRA experienced a problem that caused it to return *inaccurate* results for Single and Multiple Record Requests between approximately 9 p.m. Pacific time on Thursday, October 16th and October 17th" (Emphasis added.), as the screenshot below shows:



Just recently, members reported that the SCRA single record request was down for at least three days, from Monday, October 27-29, 2014. Below is the SCRA database screenshot for October 28, 2014:

News and Alerts

See all news

10/28/2014 5:13 P.M. PDT - Single Record Request Problem

The SCRA Website is currently experiencing a problem processing some Single Record Requests. When performing a Single Record Request you may receive a message that your request could not be completed. We are working on a solution to the problem amd expect to have full functionality restored sometime on Wednesday, October 29th. Multiple Record Requests are unaffected by this problem and continue to be processed.

We apologize for any inconvenience this may cause.

There is no advanced notice that the system will be unavailable or inaccurate, exacerbating efforts to comply, increasing the potential for violations by disrupting organizational flow of the credit approval process, and preventing lenders from promptly and efficiently serving customers as they expect.

An ABA-sponsored bank compliance network discussion demonstrates other complications associated with the SCRA database.

> *Here is some information about the DOD certificate problem. Follow the steps below to clear the error on your side.*
>
> *On the DOD site and to the right of the main DOD page that they have a link for "Help with Browser Certificate Error".*
>
> *According to the page the error is caused because we do not have their certificate installed. I looked up this general error online and Microsoft also says to install the certificate to get rid of the error. (http://support.microsoft.com/kb/931850). This seems to be a common problem with military and government sites based on posts I read.*
>
> *"Help with Browser Certificate Error".*

- *A: All internet communications between your computer and the DMDC SCRA website are encrypted using SSL standards set by the Department of Defense. Under normal circumstances, web pages are automatically encrypted using a DoD certificate public key, in order to send Privacy Act data in an encrypted form across the Internet. If the certificate is not installed on your computer, you may experience security alerts from your browser.*

  Most web browsers don't come with the DoD certificates already installed. The best and most secure solution is for the user to install all of the DoD's public certificates in their web browser. That can be done by following the Public Key instructions athttp://dodpki.c3pki.chamb.disa.mil/rootca.html. These are the official instructions provided by the Defense Information Systems Agency (DISA), which handles related security matters for the DoD.

  For corporations, businesses or individuals with a local systems administrator, we recommend that installation of the DoD certificate be handled at the IT policy level through coordination with your local systems administrator. Once these certificates are *installed, your browser should not display security warnings, as the certificate will be recognized by the browser.*

Yet, the MLA database will need to be much more robust than the current SCRA database, because the volume of inquiries will be exponentially multiplied. Lenders currently only access the SCRA database to verify status when existing active military personnel self-identify in order to obtain relief under the SCRA. This is a very small number. Under the proposal, the number of inquiries will multiply, because the database will have to be accessed for *all* consumer credit loans, and possibly multiple times for the same account as the application moves through the credit granting process. Joint accounts will require queries for all applicants. For example, nearly all student loans are cosigned. The database must also be able to handle regular periodic inquiries that may also be necessary to determine the customer's *continued eligibility* for the account and the waiver of interest and fees exceeding 36 percent. The MLA database also has to be more robust that the SCRA database because, in addition to information about active military personnel, it will have to contain information about spouses and dependents.

The Department estimates that there are 191 million applications for consumer credit each year and that 70 million of those applications will choose to query the MLA databases as a single-record check.[62] These numbers and assumptions are grossly underestimated. First, the estimates of inquiries based on a single-record check are far below what the Department can expect, given the number of consumer credit applications. Second, as noted, the regulation may require multiple inquires, because lenders, at a minimum, will likely have to inquire at application and consummation. They may also have to make subsequent and regular inquiries once the account is approved. We believe that the more realistic number of inquiries to be potentially ten times the Department's estimate.

The Department based its estimate that the regulation will produce 70 million inquiries per year on information from the New York Federal Reserve Bank of New York's "Quarterly Report on Household Debt and Credit" (Quarterly Report) of August 2013. Those Quarterly Reports provide information about the number of inquiries for credit reports and the number of certain types of loans. Payday loans and vehicle title loans are not included in the "number of inquiries," because reports are typically not obtained for those loans. They are also not included in the Quarterly Reports list of loans outstanding, though the Department estimates there to be 4.5 million of those loans per year.[63] It is not clear how the Department arrived at the 70 million inquiries per year figure, but it appears that using the information in the Quarterly Reports, the 70 million figure is far too low.

The Department notes that there were 159 million credit inquiries for the *six months* prior to the second quarter of 2013 and assumes that 60 percent of these inquiries were for credit accounts that would be consumer credit under the proposal. It is unclear how it arrived at the 60 percent assumption. A potential (perhaps inexact proxy) would be the percentage of credit card accounts open compared to mortgage and car loans outstanding reported in the Quarterly Reports. That figure is about 68 percent for Q2 2013. Applying that percentage to the twelve-month total inquiries of 317 million (157.7 million from Q1 2014 plus 159.2 from Q2 2014) means there were an estimated 215.5 million inquiries for non-mortgage, non-car loan credit. Add the 4.5 million in estimated payday and car title loans and the total reaches an annual 220 million applications for covered consumer credit, over three times the 70 million estimated.

Moreover, more recent figures are probably more predictive. The November 2014 Quarterly Report shows that there were 170.87 million inquiries in Q3 2014 and 162.45 million in Q2,2014 for a total of

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62 *Ibid.*

63 *Ibid.,* p. 58629.

333.32 million for the twelve month period. Credit cards again represented about 68 percent of the total accounts, comprised of outstanding credit cards accounts, mortgages, and car loans. Thus, based on these assumptions, the number of inquiries would total 226 million. Add the 4.5 million in payday and car title loans and the total is 230.5 million estimated inquiries per year, again more than three times the Department's estimate.

Critically, those figures are based on the single-record inquiry, which, as stated previously, is not accurate. *The number of inquiries is more likely to be at least double or triple this number—in the 450 million to 700 million range, potentially ten times the Department's estimate.*

Further hobbling lenders' ability to access the database on such a broad scale is that currently the MLA database does not appear to allow "batch" processing, although the supplementary information indicates it does.[64] Most lenders today, including many large lenders, access the SCRA database manually, though the SCRA database permits batch processing, because the volume does not justify the need. With the vast expansion of the need to access the database for every consumer credit transaction, lenders will need batch processing to manage the increased volume in an efficient matter to minimize delays in loan processing. Manual inquires on the scale required by the proposal will create delays, costs, and inconvenience to all consumers, with potential broader economic consequences.

The Department should also consider the security and privacy risks associated with providing such broad and frequent access to important information about military personnel and their spouses and dependents. All lenders, including retailers and merchants offering credit, will have to have real-time access to the database. This means they will also have to integrate the Department's systems and networks into their own, making opportunities to gain access to the Department's full database easier. Moreover, because of the value of the information, it is an attractive target for hackers. The broader access may present weaknesses for hackers to exploit.

The broader and enhanced benefits of the proposal may also hinder the Department's efforts to prevent fraud and abuse in the distribution of military benefits and entitlements as identified in its April 5, 2013, Report on "Accuracy of Data in the Defense Enrollment Eligibility Reporting System (DEERS)." One issue among others identified in that report relates to the fraudulent inclusion into the DEERS database (on which the MLA database relies) of people unrelated to the military in order to receive military benefits and entitlements illegally. If perceived as a benefit, e.g., special lower cost accounts for servicemembers and their spouses and dependents, the potential additional benefits of the MLA proposal may provide another potential attractive incentive to abuse the system and find a way to be fraudulently entered into the database.

The Department explains that shifting the responsibility for ascertaining military status from the military personnel and their spouses and dependents is necessary because there is a belief that some military personnel and their spouses and dependents are untruthful on applications. This suspicion implies that servicemembers and their spouses and dependents are not taking responsibility for their financial affairs. Nevertheless, the evidence of this falsification is underwhelming. The Department found that only 2 percent of enlisted servicemembers had used a payday loan in the past 12 months and 4 percent used vehicle title loans -- which may have included those permitted under the current regulation,[65] suggesting that only a very small number of covered individuals *might* have lied to obtain credit. A FINRA Investor Education Foundation report found that between 18 percent of

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[64] *Ibid.*

[65] Department of Defense, "Report: Enhancement of Protections on Consumer Credit for Members of the Armed Forces and Their Dependents" (August 2014), p. 20.

servicemembers surveyed used a short term "payday" loan and 20 percent used an auto title loan in the past *five* years.[66] This might suggest that some falsified the application, but it could also represent loans taken prior to active service. It may also be that the payday lender did not inquire about military status, as required, which would be a question of enforcement rather than improper disclosure.[67] The CFA study reported that "counselors knew of cases where prohibited loans were still obtained, either because military spouses falsified applications or because smaller lenders located away from the gates to the base continued to make loans to covered borrowers."[68] While these surveys might suggest a problem that should be investigated further, they are hardly compelling. We question whether the falsification on applications is widespread enough to justify the proposed massive new database and the far-reaching new mandate that all lenders query that database for every consumer credit loan. We recommend that the Department reconsider the validity and merit of the assumed benefit, especially in light of the problems identified, and allow lenders to rely on the statements of servicemembers and their spouses and dependents regarding their military status. Lenders should also be able to have access to the MLA database to verify an applicant's claim to be covered under MLA.

The Department asks whether the regulation should clarify that creditors may take advantage of the safe harbor by using a commercially provided information product whose underlying data are derived from the MLA database. Having a commercially available source as a safe harbor option may provide some convenience, although there is no such database currently available and no indications that one would be created in time to comply with the proposal. However, that a commercially available database is available should not relieve the Department of ensuring that a reliable, cost-free system is available. If the Department is going to require that creditors verify military status of all consumer credit loan applicants in order to identify the small percentage of covered applicants, it would seem appropriate that the government make the database available to creditors without cost, especially as it would appear that multiple inquiries would be necessary. Nevertheless, that would not compensate for the costs involved when the data base is not available. Including the information with a credit report might be convenient, except that the regulation would require that military status be verified at account closing, which is not usually the time to pull the report. In addition, pulling multiple credit reports is not only more expensive, but may have a negative impact on the consumer's credit score.

2. Limitations:

i. MAPR calculation and cap

The proposed MAPR is a new cost measurement calculation, distinct from "interest" and Regulation Z's APR, the calculation of the cost of credit under federal law. The proposed MAPR includes not only interest, but finance charges and fees (which may not be related to credit) as well as fees for ancillary products that are not included in the APR. The proposed calculation poses changes and challenges for all depository institution products, even when their interest rate is well below the relatively high 36 percent interest because such products exceed the MAPR cap.

The proposed calculation is a flawed measurement of the cost of credit. It includes fees that are unrelated to credit and results in an arbitrary and distorted measurement of the cost of credit.

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66 FINRA, "Financial Capability in the United States—2012 Report of Military Findings," December 2013. p. 18.

67 The CFA survey found that twenty of the thirty payday websites ask for military status on loan applications visible to visitors before personal information is required to be approved. Five were silent and five were not visible beyond the first page. It was unable to determine if military status was required later in the application. *See* Jean Ann Fox, "The Military Lending Act Five Years Later—Impact On Servicemembers, the High-Cost Small-dollar Loan Market, and the Campaign against Predatory Lending, Consumer Federation of America," May 2012, p. 26.

68 *Ibid.,* p.24.

Notwithstanding the proposal's good faith attempt to exempt some "bona fide" fees for credit cards, (but not other consumer credit), adoption of the proposed MAPR calculation will mean many products do not comply with the MAPR cap. These include popular credit card products and also affordable small-dollar loans. In such cases, the options are to make those products unavailable to servicemembers and their spouses and dependents or limit any fees, especially those for non-credit features of open-end credit products. The effect of the proposal thus will be to discourage beneficial innovation, limit beneficial features and consumer choice, and inhibit competition, all to the detriment of military personnel and their spouses and dependents as well as the general population.

The proposal anticipates that lenders would waive amounts that exceed the 36 percent MAPR cap. Assuming that is even feasible as a practical technical matter, depository institutions have indicated it will be costly, especially for small and mid-sized depository institutions. Moreover, the bona-fide fee exemption for credit cards, designed with little, if any, consideration of the perspective of the thousands of small and mid-sized credit unions and banks offering credit cards, is too vague and subjective to be of practical use for even the most sophisticated large institutions. These complications will limit loan choices for servicemembers and their spouses and dependents and may impose compliance costs that adversely affect credit availability for the public generally. To ensure that servicemembers and their spouses and dependents continue to have access to mainstream, popular depository institution products, the regulation should exempt those depository institutions from the regulation, including any MAPR cap provision.

- ***Distortion of proposed MAPR on open-end credit***

The proposal is particularly problematic for open-end credit, especially credit cards. These types of products are "lines of credit" that allow the customer to withdraw amounts, as needed, in increments of the customers' choice. Payment is flexible, and as principal is repaid, the line of credit is replenished up to the established credit limit. In disclosing the APR in advertisements, applications, solicitations, agreements etc., the APR is disclosed based on the interest rate to be applied to any balance. It excludes finance charges because whether they will be charged and other factors of the APR will be based exclusively on the future activity and choices of the customer. Previously, Regulation Z required lenders to calculate for open-end credit, retroactively, an "effective" or "historical" APR that included all finance charges for the billing statement period. However, when the Federal Reserve Board conducted focus group testing, it discovered that the distorted and inflated "effective" APRs confused consumers and detracted from the effectiveness of other disclosures.[69] Other fees, such as annual fees and application fees were never included in the effective APR calculation because they are imposed whether or not credit is extended or used and therefore are not a cost of credit.

The proposed MAPR simply does not work for the same reasons that the "effective APR" did not work and was discarded by the Federal Reserve. The MAPR will have the same distortions, creating a

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69 "The quantitative consumer research conducted by the Board validates the results of the qualitative testing conducted both before and after the June 2007 proposal; it indicates that most consumers do not understand the effective APR, and that for some consumers the effective APR is confusing and detracts from the effectiveness of other disclosures." *See 74 FR 5318 (January 29, 2009).* "The quantitative consumer research conducted by the Board validated the results of the qualitative testing; it shows that most consumers do not understand the effective APR, and that for some consumers the effective APR is confusing and detracts from the effectiveness of other disclosures" *See 74 FR 43508 (August 26, 2009).* As noted earlier, in any event, all fees must be prominently disclosed in applications, solicitations, agreements, and billing statements to ensure consumer understanding and awareness.

flawed measurement of the cost of credit. Even a $1 fee will cause a super-inflated MAPR that is divorced from the true cost of credit. To illustrate, assume a $4 transaction fee and a $100 draw made at the beginning of the month on an overdraft line of credit. This would translate to a minimum 48 percent MAPR -- before interest is included. The MAPR could be much higher, depending on when the line was used and when the balance paid. Similarly, a small foreign transaction fee, depending on the existing balance and repayment date, could easily cause the MAPR on a credit card to exceed 36 percent. More significantly, the inclusion of other fees, such as participation and annual fees will magnify the distortions and exaggerations of the calculation.

Indeed, *any* fee – even a fee less than $1 -- on an open-end loan has the potential to cause the MAPR to exceed 36 percent, because MAPR depends on factors that vary -- the amount of the fee, the amount of the loan, and the timing of loan access and repayment, all of which are controlled by the customer. For the same reason, whether the fee causes the bank to exceed the allowable MAPR will vary month to month. Thus, the fee may be waived in some months, but not others, creating confusion for customers who will not be able to predict when they can expect to pay the fee.

Including credit card annual fees in the MAPR calculation is particularly inappropriate. First, the inclusion of the annual fee ignores the fact that "credit" cards offer many other features unrelated to credit for which the cardholder pays the annual fee. Therefore, the annual fee does not represent the "cost of credit." Indeed, as noted, any fee on an open-end credit line, no matter how small, has the potential to cause the MAPR to exceed 36 percent given that a balance can be as low as $1. Second, the MAPR is incorporating an *annual* fee into a *monthly* calculation, in effect treating it as a monthly fee when it is not and distorting and exaggerating the "cost of credit."

Including fees for "credit-related" ancillary products produces the same distortions in the MAPR, as the MAPR will vary unpredictably depending on the amount of the balance, the amount of the fee, and the date of payment. The result is an inflated, arbitrary, and illogical cost of credit measurement. The result is made even more illogical because it will vary so widely based solely on who is selling the service, the creditor or a third party. Moreover, the proposal has not defined or offered examples of "credit-related" ancillary products. Presumably, it would not include products such as identify theft or credit report monitoring as those products are not related to the credit. However, if this provision is adopted, the final regulation should make clear that they are not included as they are useful and popular products that alert consumers, including servicemembers and their spouses and dependents, of potentially negative events and give them peace of mind that they will be alerted if something goes wrong.

- ***Months when there is no balance***

The proposal provides that in billing cycles where there is no balance on the account, no fee or charge may be imposed, except for a participation fee that does not exceed $100 per annum. The proposal does not say whether the "$100 per annum" is cumulative if imposed, for example, on a monthly basis, but it appears that a monthly fee under $100 may be permissible even if imposed each month and the amount would be greater than $100 over the course of a year. The cap does not apply to "bona fide" credit card annual fees.

"The Department believes that $100 is the highest reasonable amount that a creditor could charge as a bona fide participation fee," but provides no basis for its belief.[70] As discussed later, the exemption for "bona fide" fees for credit cards simply does not work. Thus, credit cards, as a practical matter, are

[70] 79 FR 58619 (September 29, 2014).

subject to this arbitrary effective cap on annual fees. Moreover, while we are not aware of depository institutions offering non-credit card open-end products that impose such a fee, the arbitrary cap (untied to inflation) would preclude the development of innovative products that might include other valuable features and rewards – beyond simply credit -- that benefit consumers, including military personnel and their spouses and dependents.

- ***Feasibility and costs of options when MAPR exceeds 36 percent***

In addition to the issues described above, there are questions and complications regarding the process to calculate the MAPR and options if it exceeds or may exceed 36 percent. Under the proposal, depository institutions of all sizes will have to calculate retroactively the new MAPR for all open-end credit including credit cards, overdraft lines of credit, and personal lines of credit if they happen to impose an application fee, transaction fee, or any other fee. They must then take the second step of waiving amounts exceeding 36 percent MAPR, all in time to produce the billing statement within the strict timeframes required under Regulation Z. Given the time constraints and the complexity of the proposal overall, we have not had the opportunity to investigate thoroughly the methods, feasibility, and costs to identify covered customers and complete the required steps described above. However, initial responses are that it will be a significant challenge and costly, if even feasible as a practical matter.

Calculating the MAPR and then waiving excess fees sounds simple, especially with the sophisticated technology of today's world. But it is not, especially given the volume of accounts involved and the limitations of even advanced systems. It is not clear whether it is feasible to "tag" select customers and then manually or automatically waive select fees or fees exceeding the cap. Even depository institutions with sophisticated systems would be challenged and confounded. The obstacles are greatest for small and mid-sized banks and credit unions, which offer open-end products, including credit cards, and which do not appear to have been considered in the formulation of the calculation. Initial inquiries with depository institutions have indicated that creating or modifying any automated system to accommodate any solution would be extremely complicated and disruptive of the information technology (IT) schedules, a costly and risky disruption for insured depository institutions. If even feasible, it would also require a lengthy implementation period.

One alternative to avoid the burdens and risks of calculating the MAPR for accounts held by military personnel and their spouses and dependents is to eliminate all fees on open-end products (though that does not allow depository institutions to escape the other requirements of the proposal that might ultimately cause them to abandon or not offer products). Elimination of all fees, however, will create inefficiencies by restricting the ability to allocate costs to specific features and result in some borrowers subsidizing others. Most importantly, it will erect a barrier to developing novel and valuable products and services and will stifle innovation to the detriment of American consumers who expect and demand novel and better choices. Under this alternative, competing institutions will be compelled to stick to the same undistinguished, plain vanilla products – rather than differentiate and compete with products driven by consumer demand and innovation -- if they are to continue to offer their mainstream products to military personnel and their spouses and dependents.

Another potential option to avoid the 36 percent MAPR cap, at least for some products, is to require minimum draws on lines of credit, increasing the balance and thus lowering the MAPR. However, this encourages customers to borrow more than they need, which increases what they pay and may tempt them to overspend.

Given the challenges, complexities, and costs of creating a system to segregate a small minority of customers, calculate the MAPR, and waive fees, especially when coupled with all of the other provisions in the proposal and the accompanying risk, a rational choice for individual lenders or the market as a whole might be simply to not make those products available to covered borrowers or not offer covered consumer credit to anyone. The Banking Agencies' guidance on deposit advances illustrates the unintended consequences of such rules. That well-intended guidance did not improve a popular and well-regarded product. It virtually eliminated it and has also discouraged development of other bank affordable small-dollar programs. These results do not benefit consumers, including military personnel and their spouses and dependents, in terms of choice of product feature, choice of institution, or competition, which enhances product quality and moderates prices.

Small mid-sized depository institutions will have the fewest options, as they lack the internal technology systems and resources the large institutions *may* have to calculate the MAPR and waive fees for such a small percentage of customers or to segregate military personnel and their spouses and dependents and offer them special accounts. Instead, smaller institutions must rely on the "standard" processing systems offered by third party-processors and have little if any flexibility to require special processing or calculations or to tailor their product. There are few attractive options in the likely case that their third-party processor does not offer the capability. They might be able to change third-party processors (which is a significant step that presents other risks) if they can find one. Thus, they are more likely than large institutions to be left with the undesirable options of eliminating all fees and other services associated with the account, limiting access by servicemembers and their spouses and dependents, or eliminating the products altogether, putting them at a significant competitive disadvantage.

If the Department does not exempt depository institutions, we urge it to abandon the proposed MAPR calculation or any variation. Not only is the calculation an arbitrary and flawed measurement of the cost of credit, the practical implications will have unintended and detrimental consequences on military personnel and their spouses and dependents as well as American consumers. Moreover, modifying the types of fees that are included or excluded will not solve the basic problem associated with the technical challenges of designing systems to calculate the MAPR and waive fees for select customers.

- ***Bona fide fees***

"Reasonable and customary." The proposal allows credit cards only to exclude from the MAPR calculation bona fide fees that are both reasonable *and* customary (except for credit insurance premiums and fees for credit-related ancillary products). The proposal offers no other adjectives or guidance to explain the meaning of "bona fide" beyond reasonable and customary. As we illustrate below, the proposed exemption from the MAPR of bona fide fees for credit cards imposes a process of justification that is not a feature of free market pricing. Adding this administrative hurdle to offering of financial products to the military only increases the disincentive to provide those products and underscores the risk of getting too close to the line that the Department is setting to limit intentionally servicemember choice. After all, one provider's view of "bona fide," "customary," or "reasonable" will become, in the eyes of an enforcement agency or plaintiff's counsel, the suspect rationale to prove a claim of regulatory evasion.

For a bona fide fee to be reasonable and customary, it must be compared to fees "typically imposed by other creditors for the same or substantially similar product or service." A bona fide fee is "reasonable" (but not customary) if it is less than or equal to an average amount of a fee for "the same or a substantially similar product or service" charged by 5 or more creditors each with at least $3 billion in outstanding loans on U.S. credit card accounts at any time during the 3-year period preceding the time such average is computed. A fee higher than such an average may be reasonable (but not customary) "depending on other factors relating to the credit card account." Under the heading "Indicia of reasonableness for a participation fee," a fee may be reasonable and customary if the amount "reasonably and customarily" corresponds to the credit limit, "to the service offered under the credit card account, or to other factors relating the credit card account." If a creditor imposes *any f*ee that is not a bona fide fee and imposes a finance charge, the total amount of those fees, *including* any bona fide fees and other finance charges shall be included in the MAPR.

We appreciate the Department's effort to incorporate some flexibility into the MAPR calculation in an effort to ensure that military personnel and their spouses and dependents continue to have access to mainstream, popular, and valuable credit cards without allowing possible circumvention by even a single lender. The bona fide exception for credit card fees, however, while well-intended, simply is not usable either by the thousands of small and mid-sized credit unions and banks that offer credit cards or by the largest, most sophisticated institutions. In addition, taking the costs of the largest providers who enjoy economies of scale and imposing them as a fee structure on smaller providers who do not enjoy those economies, is plainly anti-competitive.

The standard is contradictory and too vague and subject to interpretation to make compliance possible, let alone certain. Given its subjectivity, the vagaries of regulatory compliance, the draconian consequences for violations, and the attractive target it presents to plaintiffs' attorneys, the bona fide exception will not be available as a practical matter. Accordingly, most credit card accounts, especially cards with popular rewards programs, as well as high value, high cost cards, will exceed the MAPR cap, and thus potentially be out of reach for military personnel and their spouses and dependents. In addition, even if it were workable, this approach, in effect, potentially forces card issuers to march in lock step so that they all have similar fee structures as well as features, leaving consumers with little choice except for the "vanilla" product.

First, a fee that few or no other creditors charge is tautologically "not customary" and consequently will be deemed ineligible for the exception. Cards with such fees, including high value, relatively high cost cards and cards with unique features for which there is a charge, will be unavailable to military personnel and their spouses and dependents. Proposed Section 232.4(d)(1) provides that any fee must be both reasonable and customary to be considered bona fide. Under 232.4(d)(3), to assess whether fees are reasonable and customary, they must be compared to fees "typically" imposed by other creditors for the same or a substantially similar product or service." Even though a fee may not violate the "reasonable" test under Section (D)(3)(iii),"solely" because other creditors do not charge a fee for the same or substantially similar product or service, it will not meet the customary test because it is not "typical," which is the test under (D)(3)(i).

By definition, then, if the fee is for a service no other creditor offers, it is not bona fide and must be included in the MAPR. Similarly, a fee is not bona fide if other cards issuers do not charge that fee, even though that card issuer may not impose other fees for services that other card issuers "typically" impose a fee.

As discussed, those fees will always have the potential to cause the MAPR to be greater than 36 percent (as even with a minimal fee if there is a low balance of if the fee is incurred late in the billing cycle, the MAPR will exceed 36 percent). This means, in effect, from the time the regulation goes into effect, no new fees, including those for novel and beneficial features that promote competition, can be bona fide. Thus, military personnel and their spouses and dependents are ineligible for any novel card or feature, regardless of value, merits, or suitability.

Second, the standard for "reasonable and customary" fees, that is, those "typically" imposed by other creditors for "the same or substantially similar" products or services, cannot be met because of the subjectivity and vagueness of the meaning of key terms such as "typically" and "same or substantially similar," as illustrated below. The uncertainty and subjectivity of the terms, even if they were defined, would raise "questions of fact" that only a court may determine after discovery and trial, making card issuers easy target for private lawsuits and forced settlements for meritless cases.

Third, the Department "believes that most creditors impose bona fide fees expressly tied to specific products or services connected to using the credit card itself and segregable from the cost of funds borrowed."[71] An analysis of credit cards would illustrate otherwise.

With the myriad of features and pricing structures in the U.S.'s competitive credit card market and the number of issuers, including the many small and mid-sized depository institutions offering credit cards, it becomes clear that the comparison the regulation envisions and presents as simple cannot be made, at least not in any rational, predictable, or meaningful fashion. The proposed standard is flawed because it fails to recognize how credit card features and pricing are woven together to produce a package. Contrary to the assumption of the proposal, there is no comprehensive, uniform menu among all issuers that can isolate individual features and fees. It is like trying to compare health club or gym memberships. It is not possible to identify in an objective fashion, "substantially similar" health clubs when there are so many issuers and variables, including location, services, facilities, staff, and number of members. Are clubs with a pool "substantially similar"? Does the size of the pool matter? What if one is frequently more crowded, and thus often not available? Are they substantially similar if one offers a sauna and the other a hot tub and another neither? How does the availability of instructor-led classes, the quality of weights, or the number of stationary bicycles and stair-masters fit in? What if some charge extra for bottled water and gym clothes but others do not or do not offer them at all? While critics might be able to offer subjective opinions and recommendations based on the different needs and preferences of different types of people, they cannot offer a non-normative comparison that is in the least bit usable in a regulatory context, especially when the stakes are so high. The same is true for credit cards with their myriad features that appeal to different customers differently, depending on their personal preferences.

With credit cards, as with many products, there is interplay between the various fees and the various features, *including many non-credit features*, both of which are mixed in different combinations to appeal to the varied preferences within the American population. Even among members of the military or within branches of the service, let alone their dependents, there is not a single, uniform set of preferences for product feature trade-offs. Because of the infinite variety of combinations, the products are not comparable in the simplistic way the proposal envisions. To illustrate with even the most simple, basic example, a card with a high annual fee might have a relatively low interest rate and a card with a no annual fee have a relatively high interest rate. Are they "substantially similar"? The card with the higher annual fee would produce a higher MAPR in the month in which it is imposed, but overall be less expensive to the cardholder depending on how the cardholder chooses to use it. What if the annual fees are the same, but the interest rates very different? How do they compare if there is a promotional interest rate? Similarly, another card might charge for foreign fee transactions but provide free car rental insurance. Its foreign transaction fee, however, might be above the average and therefore not bona fide, whereas the card not offering car rental insurance would be permitted to charge the fee.

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71 *Ibid.,* p. 58610.

Identifying "substantially similar products or services" is made even more confounding by the wide spectrum of fees and the variety of features and services consumers enjoy with their credit card and the infinite combinations. As the proposal seems to recognize, at least in part, credit cards provide far more than credit, and the cost and availability of these services and benefits are reflected in various fees, including, *but not limited* to annual fees. Indeed, in some cases, the credit feature is almost ancillary to the product. Features include warranties for purchases made with the card, car rental insurance, rewards in a multitude of various forms, including cash back, free airline baggage, access to airport lounges, concierge services etc. They include features for which there may be a separate fee the card issuer imposes. For example, through a special arrangement with a club, a card issuer may offer club membership at a discount if purchased *through* the card issuer (not simply charged to the card).

This list does not include features under consideration or those that might be available in the future as card issuers compete for customers. Whether a fee is imposed and the amount of any such fee for a particular service or feature will depend not only on that particular service, but also on *other* services or features that the card offers -- or does not offer -- and whether there are fees for those services and fees. *Fees and services are simply not "segregable" across credit card products as the proposed definition of bona fide fees would require.* Thus, as illustrated in the example of foreign transaction fees and car rental insurance, it is not possible to make a fair comparison. The results will be distorted.

Simply put, the credit card market and business models are much more nuanced and complex than the proposal reflects, as consumers respond to the package as a whole, based on their own preferences and habits. For these reasons, the simplistic comparison among cards is unworkable and therefore not usable. At best, any comparison among credit cards is general and subjective and not suitable as the basis of a rigorous legal standard for which the consequences of violations are so severe. Any conclusion based on the proposed standard can only be arbitrary, subject to second-guessing by regulators and plaintiffs' lawyers. In other words, the bona fide exception appears designed for violations.

Equally problematic is the ambiguity and fuzziness of the meaning of the words "typical" and "substantially all creditors." For both the customary and reasonable tests, the comparison must be between "typical" fees. "Typical" is not specifically defined. It is, however, used in the explanation of the meaning of "customary" and appears to have the same meaning as customary. Under Section 232.4(d)(3)(iv), a "A bona fide fee computed as a percentage of the amount of a transaction is *customary* . . . *so long as* other creditors *typically compute, or customarily have computed*, that fee for the same or substantially similar product or service on a percentage basis." However, the section then continues that "fixed amounts can nevertheless be customary "even if substantially all other creditors currently compute that fee on a percentage basis." Thus, it appears that even if only a small percentage of issuers charge a fee or compute a fee in a particular fashion, it is nevertheless customary or typical. This seems to contradict the "typical" or "customary" understanding of these words. It is impossible to resolve this contradiction from a legal and regulatory perspective.

Furthermore, the proposal does not offer guidance on the meaning of "substantially all other creditors." Given the high and ever-changing numbers of card issuers and the difficulty in obtaining those details, as discussed later, we do not believe it is possible to provide a workable, meaningful standard that can fairly and predictably be met. Moreover, by definition, any new fee or fee not imposed by the largest issuers must be included in the MAPR – or the account not made available to military personnel and their spouses and dependents.

Indicia of reasonableness for participation fees. The proposal attempts to make an accommodation for one fee only, the annual fee for credit cards. It provides that a participation fee in a credit card account may be reasonable and customary if the amount "reasonably *and customarily* corresponds to the credit limit in effect or credit made available when the fee is imposed, to the services offered under the credit card account, or to other factors relating to the credit card account." As an example, a $400 annual fee may be reasonable and customary (relative to other accounts) if "the credit made available to the covered borrower is significantly higher or additional services or other benefits are offered under that account." In order to qualify for the exception and determine whether their annual fee is reasonable and customary, card issuers would have to be able to assign a value to all of their own services and features and to the level of the credit limit. They would also have to be able to compare their services and prices with other card holders and to assign a value to their competitors' products.

This exemption is unworkable and unlikely to be used because (1) there is no means for placing values on the numerous and varied services which might permit an annual fee that is above average; (2) even if there were, there are complications and challenges, including potential antitrust implications associated with obtaining the fees and details of features of competitors and assigning the services, fees, and credit limits of their products; (3) the exception does not cover atypical fees as they do not meet the "customary" test; and (4) the standard is so subjective and uncertain, it will attract meritless but expensive lawsuits if used.

To illustrate the practical impediments of the exception, how does a card issuer value and compare credit limits, especially as they vary based on the individual customer? How does it assign value to and compare the numerous and varied features and benefits, including those that have not yet been introduced? What is the value of free baggage and does the value change based on the number of items allowed for free? What is the value of priority boarding and is it different if it is limited to one airline? What is the value of airport lounge access and what are the differences if access is limited or unlimited or one offers a substantial discount on club membership with unlimited access and another provides limited access for free? What is the value of warranties? Does it change based on the exemptions from warranty coverage? What is the value of all the different types of rewards, of retail card discounts and special offers, of car rental insurance, of concierge services, of restaurant, hotel, and travel services, all of which vary in their level of service and limitations? The value of these services also all depend on individual customer use. For some, the value may far exceed the annual fee. For example, a customer paying a $100 annual fee that allows two free bags per flight for on an airline will cover the annual fee with a single flight, checking two bags.

Moreover, even if it were possible to make a meaningful comparison, it is not clear how this information would be ascertained or obtained, as discussed below. The agreements posted on the Bureau's website do not provide nearly the necessary level of detail with regard to features and benefits, let alone their value. Nor can issuers rely on SEC filing, Call Reports, or other commercially available databases as the Department assumes. Contrary to the Department's assumptions, these resources simply do not contain the information needed to make the comparison. Obtaining it using other methods is fraud with other risks as they would inevitably raise antitrust issues. Even if it were possible to obtain the needed data, it would not solve the problem with ascertaining the "credit made available" as it is unique to each customer, so therefore cannot be compared issuer to issuer.

Furthermore, as noted earlier, it appears that even if card issuers were able to analyze and compare the values of the services to support a claim that the annual fee is reasonable, it may still fail the customary test under Section (d)(3)(i) if other issuers with similar credit limits and services and benefits "typically" do not charge a similar fee. Thus, the annual fee would be included in the MAPR and cause the MAPR to be greater than 36 percent. Accordingly, military personnel and their spouses and dependents would be ineligible for such cards.

The usability of this exception is further constrained and complicated by Section 232.4(d)(4). That section provides that even if a fee is bona fide, if *any other* fee imposed is not bona fide, then the bona fide fees are no longer bona fide.

Finally, the standard also appears to neglect the number of depository institutions offering credit cards and takes the perspective of the largest institutions. In fact, as noted, there are thousands of small and mid-sized institutions issuing credit cards. They may use third-parties or other institutions to process transactions, but they set their own prices. For example, ABA and ICBA offer programs that enable their members to offer credit cards. However, the trade associations do not – and cannot, under antitrust laws -- dictate or even suggest pricing. Thus, institutions would have to conduct their own legal analysis to determine whether their fees are bona fide, which is not a practical option given the vagaries of the regulation as discussed and the lack of the teams of lawyers and compliance officers that would be necessary.

In sum, the complication, vagueness, and limitations of the bona fide exception make it unusable. The exception would, in effect, be illusory. Thus, card issuers would have to weigh the costs and feasibility of calculating the MAPR of a very small percentage of customers, and waiving the fees otherwise charged to all other customers who value the product against the option of simply conceding to the Department's limitation of military choice for products that trigger the MAPR threshold thereby discontinuing to offer those products to military personnel and their spouses and dependents.

Means of comparison for safe harbor. The Department envisions that creditors "could readily calculate whether each type of fee may fit within the safe harbor because data relating to the fees imposed by other credit card issuers as well as the amount of credit card loans outstanding are widely available."[72] Specifically, it believes that creditors may rely on SEC filings and Call Reports as well as agreements that are posted on websites and other sources such as "commercially available databases regularly used by financial institutions to track the marketplace for credit card products and services."[73] It is our understanding that none of those sources provide the critical information or the level of detail necessary to make the comparison of the rates, fees, features, services and credit limits as discussed above. First, neither SEC filings nor Call Report contain information about product pricing or features. The SEC filings contain at best aggregate interest rates by product segment and very general, brief descriptions of the types of products offered, (e.g. credit cards, auto loans), but no product-level price and feature terms. Call reports also contain no information about product pricing or features.[74]

Second, information on websites, such as the Bureau's website, is limited and lacking in the necessary detail or reliability the regulation demands. For example, only ranges of annual fees and interest rates are posted on the Bureau's website, e.g., annual fees for a particular card issuer range from $0 to $250 and interest rates from 10 percent to 18 percent. Promotional rates may not be available. Credit limits may also only be listed as ranges – or may be "unlimited." Moreover, as noted, credit limits vary based on individual customers, as required under federal law[75] so it is not clear how to compare credit limits. Similarly, we do not know which "commercially available databases regularly used by financial institutions to track the marketplace for credit card products and services" that the

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72 *Ibid.,* p. 58612.

73 *Ibid.*

74 *See* FFIEC, "Instructions for Preparation of Consolidated Reports of Condition and Income," http://www.ffiec.gov/pdf/ffiec_forms/ffiec031_034inst_200006.pdf

75 Section 1026.51 of Regulation Z prohibits providing credit card credit or increasing a credit card limit unless it has considered the consumer's ability to repay. For customers under 21, the customer must have an "independent" ability to repay. In addition, OCC guidelines only permit increases in limits based on updated information about income and assets.

Department is referencing, but none of the large credit card companies we queried is aware of any such database. Websites targeted at consumers to assist them in shopping for credit cards offer information on various credit cards, but neither the list of cards nor the list of terms is by any means comprehensive or detailed. Certainly, these websites would not be of any use in complying with the rigorous standard of the regulation.

Even if additional information on these terms were available in greater detail, it would not solve the issue discussed above about the interplay between various fees, interest rates, credit limits, and services and features. These sources do not provide the information and detail necessary to compare the different features and benefits in order to identify "substantially similar products or services" even if such a comparison were feasible. Thus, creditors would not even get to the price comparison because of the inability to identify the components of the products they must compare.

The necessity to gather or share such information provision also raises potential antitrust issues, both in obtaining the information if card issuers were to attempt to use the exception as well as modifying prices to align with competitors, as the proposal envisions. We believe that even if this bona fide exception were to be workable, a thorough analysis of the information available and the very important antitrust issues need to be examined and resolved. Otherwise, the exception is in name only.

The proposal is also lacking in critical detail. For example, the proposal requires comparison with a minimum of five "creditors." Card issuers often offer suites of cards to appeal to a wide variety of consumer tastes. The supplementary information suggests that they may use the highest fees. However, to be useful as a reliable standard, that permission would have to be expressed in the regulation itself.

- ***Distortions of MAPR on closed-end credit***

The MAPR challenges are less acute for some closed-end loans, in that, if the loan is sufficiently large, depository institution products are unlikely to trigger the MAPR cap. However, there remain significant compliance and technical challenges as discussed above, as the proposal will require that depository institutions have controls to test and ensure that they do not inadvertently exceed the MAPR. At this time, given the complexity and the breadth of the proposal, we have little precise information about the challenges, feasibility, and costs associated with implementing the necessary controls for closed-end loans offered by credit unions and banks. However, some lenders impose finance charges, such as a fee to obtain a credit report, which could mean the product exceeds the 36 percent MAPR, especially for small-dollar loans. Others might impose an application fee that would cause the MAPR to exceed the allowable percent.

To illustrate, the National Credit Union encourages credit unions to offer a "Payday Alternative Loan," a low cost, small-dollar loan. Loans range from $200 to $1,000, with application fees not to exceed $20 and an interest rate not to exceed 28 percent APR. Terms range from one to six months, with no roll-over and limits on consecutive use. However, many of these loans, with the application fee, would exceed the 36 percent MAPR cap. For example, a one month $500 loan with a $20 application fee would reach 48 percent MAPR and a $200 loan a 120 percent MAPR *before* interest is included. In addition, the Department cites in its April 2014 Report examples of bank products that are suitable alternatives to payday loans of a low-cost small-dollar bank product.[76] One of the products, for example, offers loans as low as $300 for periods as short as four months at a low interest rate. However, the $35 application fee, to cover fixed costs, such as the credit report, overhead, including staff salary and

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[76] Department of Defense, "Report: Enhancement of Protections on Consumer Credit for Members of the Armed Forces and Their Dependents" (August 2014), p. 15.

benefits, would result in a 45 percent MAPR – *before* adding the relatively low interest. This demonstrates how even a modest fixed fee to cover some of the costs of providing the loan will cause the loan's MAPR to exceed the cap. Other loans, such as those secured by deposits, (e.g., certificate of deposit or saving account) which are generally prohibited under the proposal, might involve collateral filing fees that could easily cause the MAPR to exceed 36 percent MAPR. These examples of products encouraged and even endorsed by regulators illustrates the serious unintended consequences of the proposal of the impact on affordable small-dollar loans.

ii. Prohibition against liquid secured credit and access to bank accounts

Under the proposal, military personnel and their spouses and dependents will be ineligible for consumer credit secured by liquid collateral. In addition, the proposal's limitations on the ability of lenders to access covered borrower's deposit accounts raises additional legal and reputational risks for depository institutions.

Liquid secured consumer credit includes open and closed-end credit secured by deposits and financial accounts, including, for example, secured credit cards. These common and consumer-friendly products are often small-dollar in nature and help consumers with a negative credit history rebuild their credit record and consumers with no credit history build one. Over time, these improved credit histories and scores allow consumers to qualify for other forms of credit, including car loans and mortgages and also have numerous positive impacts in other areas of a consumer's financial life. Finally, these flexible and beneficial products provide all consumers with a generally less expensive credit option than equivalent unsecured credit products.

However, Section 232.8(e) of the proposal makes it unlawful for any lender to extend consumer credit to a covered borrower if the lender uses a check "or other method of access to a deposit, savings, or other *financial account* maintained by the covered borrower." (Emphasis added.) The regulation includes several exceptions to this prohibition, including one that permits lenders to ". . . take a security interest in funds *deposited after the extension of credit* in an account established in connection with the consumer credit transaction." (Emphasis added.)

There are at least three concerns with this language. First, depository institutions that extend liquid secured credit take their security interest in the deposit or financial account at the time the account is established or the loan is consummated. As a result, they are taking a security interest in funds deposited *before or simultaneously with* the extension of credit. As such, this language will prohibit depository institutions from offering liquid secured consumer credit to military personnel and their spouses and dependents. As we pointed out in our June 11, 2007 letter on the regulation proposed in 2007:

> Not included in this exception are deposits made prior to the loan. This means that service members and their spouses and dependents may not use their existing savings accounts as a security for a loan. We do not see this as having a significant impact at this time because of the narrow definition of covered credit. However, if the regulation were applied to a broader array of loans, service members and their spouses and dependents would face additional restrictions and higher credit costs if they are unable to use existing savings accounts, including certificates of deposits, as security for a loan.

Second, it is far from clear what constitutes a "financial account" for purposes of this broad prohibition. For example, it appears that this section may also prohibit security interests in securities accounts and insurance policies. Therefore, servicemembers and their spouses and dependents will not be permitted to obtain credit secured by these types of collateral to covered borrowers – no matter how sophisticated the servicemember, spouse, or dependent or how useful the option.

Third, the proposal raises serious questions about a depository institution's ability to access covered borrower's deposit accounts pursuant to any statutory or common law right of offset that it may have under applicable law. This creates another legal and associated reputational risk for depository institutions in lending to servicemembers and their spouses and dependents. The proposal's deletion of the following language from the regulation's current definition of payday loans compounds this risk: "This provision does not apply to any right of a depository institution under statute or common law to offset indebtedness against funds on deposit in the event of the covered borrower's delinquency or default."[77] The limitation makes it even more difficult to lend to servicemembers and their spouses and dependents. In addition, the added risks potentially increase their costs.

As noted, liquid secured credit is a popular and safe way to rebuild credit and a flexible and beneficial product for many covered borrowers and consumers. One large bank reported that it opened approximately 450,000 new secured card accounts in 2013. The same bank made nearly 18,000 personal loans and lines secured by certificates of deposits and savings accounts, and over 14,000 personal lines secured by securities accounts in 2013.

Presumably, the statutory provision upon which this section of the proposal is based was intended only to target payday lenders by prohibiting those lenders from using post-dated checks and direct debit to get access to the borrower's checking account. However, under the proposal, this prohibition will unintentionally cut off not only a valuable tool for covered borrowers to rebuild or build their credit histories, but also the availability of a consumer-friendly, small-dollar, credit alternative. It is another reason to exempt depository institutions from the regulation.

iii. Prohibition against waiving right to legal recourse

The proposal prohibits depository institutions from providing consumer credit if the covered borrower is required to waive any right to legal recourse. This prohibition will have a profound and widespread impact on institutions lending to servicemembers and their spouses and dependents. Beyond the significant and grossly underestimated expense, the proposal will substantially increase legal, regulatory, and reputational risk exposure. These costs and risks, which appeared to have been overlooked, will ultimately negatively impact consumer credit availability and costs for military personnel and their spouses and dependents.

Proposed Section 232.8 (b) prohibits lenders from extending consumer credit where the covered borrower is required to waive their "right to legal recourse under any otherwise applicable provision of State or Federal law," including any provision of the Servicemembers Civil Relief Act (SCRA). "Right to legal recourse" is not defined in the proposed regulation, and no examples are provided, although the supplementary information indicates that nothing in the proposed regulation affects the federal law governing the interest rate a financial institution may charge.[78] However, it also appears that the

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[77] 32 C.F.R. § 232.3(b)(i)(B).

[78] The Department makes clear that "nothing in 10 U.S.C. 987 or this regulation should be construed so as to affect the Federal law governing the interest rate a financial institution may charge," noting in footnote 132, "In the case of a national bank, for example*,* see 12 U.S.C. 85; 12 CFR 74001." *See* 79 FR 58617 (September 29, 2014).

Department[79] and Bureau[80] currently view this provision as broadly prohibiting the waiver of *any* otherwise applicable state or federal law. The Department also believes that there are no material costs associated with this provision.[81]

Every depository institution currently offering consumer credit includes in its consumer credit forms provisions under which the consumer explicitly or implicitly waives rights to legal recourse. These standard waivers, which are permissible under state and federal law and include conflict of law provisions, are ubiquitous. Over the past 50 plus years, they have helped foster and encourage the development of a robust and efficient consumer credit market, which, in turn, has maximized the availability of low-cost consumer credit. The unanticipated consequences to the consumer credit market generally, and to military personnel and their spouses and dependents specifically, from this proposed broad prohibition cannot be overstated. The discussion below demonstrates the significant and sweeping impact of the prohibition of some of the legally permissible and commonly incorporated waivers the regulation covers.

Conflict of law waivers offer an example of the impact of the prohibition. As we explained in our comment letter of January 5, 2007 to the original proposed regulation, the prohibition against waiving rights to legal recourse presents lenders with an impossible task if they wish to continue lending to servicemembers and their spouses and dependents. Lenders have to first identify all of the possible applications and permutations of this limitation and then redraft either their current multi-state documents to comply with all of the potentially applicable laws in all 50 states and the District of Columbia or create 51 state-specific versions of each of their consumer credit forms. As stated in the depository institutions 2007 letter to the proposal:

> [T]he wording of this provision is arguably so broad as to make it illegal to have a substantive provision in the credit agreement that otherwise forecloses some other course of action that may have been available under the credit-related law of any jurisdiction. This makes it virtually impossible for the lender to design loan programs and draft legal documents to cover them; it also creates an endless source of arguments for borrower's counsel that they may use in an effort to void the loan.
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> For example, a standard choice of law provision choosing, for the sake of illustration, the law of the State of Ohio to govern the contract for the extension of credit necessarily excludes (where such choice of law provision is effective) the law of the other 49 states and the District of Columbia, meaning that the borrower is being required to waive "right to legal recourse" under the law of some other state, arguably in violation of the Payday Law. Similarly, a choice of federal law applicable to the credit agreement would be prohibited, with the result of undermining well-settled law with respect to federal preemption. For example, presumably the federal law choice of "interest" applicable to the contract as established by such longstanding U.S. Supreme Court cases as *Marquette Nat. Bank v. First of Omaha,* 439 U.S. 299 (1978) and

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79 "For example, the Department believes that the costs associated with the prohibition against requiring a covered borrower to waive his or her rights under *any* otherwise applicable provision of law (as provided in proposed § 232.8(b)) is not material to this regulatory impact assessment because the potential costs of this prohibition are negligible." (Emphasis added.) *See* 79 FR 58626 (footnote 177) (September 29, 2014).

80 *See,* Ask CFPB "What are my rights under the Military Lending Act?" (updated August 8, 2014) providing: "Creditors cannot require you to waive *any* state or federal law, including the [SCRA], which protects servicemembers from being sued while on active duty." (Emphasis added.) http://www.consumerfinance.gov/askcfpb/1783/what-are-my-rights-under-military-lending-act.html

81 79 FR 58626 (footnote 177) (September 29, 2014).

Smiley v. Citibank, 517 U.S. 735 (1996) would no longer be applicable to credit extended to a person covered by this new law because that would "waive the borrower's right to legal recourse under any otherwise applicable" law. This means that credit card and other loan programs designed to comply with these cases will be unavailable to military personnel and their spouses and dependents. If depository institutions were to create products for military personnel and their spouses and dependents, the institution would be required to design completely new credit card and loan programs that must comply with every possible state law that may apply. Thus, for its normal loan programs, a depository institution could rely on one uniform choice of law governing "interest," but for any credit card and loan programs applicable to the small minority of borrowers covered by the Payday Law, the compliance costs of designing credit card and other loan programs that comply with the law of all 50 states and the District of Columbia would be a significant expense and deterrent, if even possible to do. And, even if possible, the corresponding compliance costs would add substantially to the costs of providing credit, ultimately reflected in the consumers' cost of credit.

This provision even appears to go so far as to prohibit affirmative substantive choices within the law of a given state when, without such a provision, a different result would occur by default under applicable state law. For example, the Uniform Commercial Code and other state laws often enact basic provisions that apply in the absence of the parties contracting differently, simply to provide terms where the parties fail to do so. Under the Payday Law, if the parties in fact contract differently than as provided under such provisions that would otherwise apply by default that will presumably be considered requiring the borrower to waive "the borrower's right to legal recourse under any otherwise applicable provision of State or Federal law." Thus, before a loan program can be designed and documents drafted, counsel for depository institutions will be required to conduct an exhaustive review of all laws of the applicable state (and because of the possible application of the law of all other states, this same process must be done for the law of all 50 states and the District of Columbia) to discover where any applicable law provides some choice in order to be sure that such choice is not foreclosed by the program (and thereafter continually update the research and loan documents) -- effectively an impossibly complex task.

Those arguments and concerns remain.

The proposed prohibition also impacts explicit waivers. For example, a standard consumer credit promissory note from a forms vendor includes the following multi-state waiver language: "Waivers. To the extent not prohibited by law, I [borrower] waive protest, presentment for payment, demand, notice of acceleration, notice of intent to accelerate, and notice of dishonor." Protest, presentment, demand and notice of dishonor are negotiable instrument concepts, the waiver of which has been recognized[82] and specifically permitted by the Uniform Commercial Code.[83] Notice of acceleration and notice of intent to accelerate are statutory and/or common law concepts, the waiver of which is also often permitted by state law.[84] Most consumer promissory notes are negotiable instruments and include these standard waivers to make them as liquid and transferable as possible and to allow depository institutions to reduce and control costs that would otherwise have to be passed on to consumers.

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82 "Any other types of waivers (for example, waivers of demand, presentment, protest, notice of dishonor, and notice of protest are not prohibited [by Reg. AA]." *See* Federal Reserve Board, Consumer Compliance Handbook, Reg. AA (page 1):

83 *See* Uniform Commercial Code § 3-501 et seq.

84 *See e.g., Shumway vs. Horizon Credit Corp., 801 S.W.2d 890 (Tex. 1991).*

In addition, this same vendor's promissory note includes the following security specific language: "Waivers: I [borrower] waive all claims for loss or damage caused by your [lender's] acts or omissions where you [the lender] acted reasonably and in good faith. I [borrower] waive all rights I have now or in the future to a homestead or personal property exemption in the [collateral]." These standard waivers are also common in consumer personal property security agreements. The waiver of claims language is specifically permitted by the Uniform Commercial Code[85] and the waiver of homestead and personal property exemptions are authorized by most states and specifically permitted by Regulation AA (Unfair and Deceptive Acts or Practices) when the property is collateral for a consumer credit obligation.[86] These waivers, particularly the latter, enable depository institutions effectively and efficiently to reach the collateral for the consumer loan when necessary. The ability of depository institutions to keep recovery costs low on defaulted loans directly translates to the depository institution's ability to keep the cost of credit lower for all consumers.

Depending upon the jurisdiction and type of consumer credit transaction involved, numerous other explicit waivers may be included in a promissory note or credit agreement. For example, other common explicit waivers include general waivers of defenses associated with the lender's ability to: renew, extend, modify, or sell the loan; release borrowers, guarantors or co-signers; release or substitute collateral; and exercise any statutory or common law right to set-off. Waivers of notices/defenses based on suretyship[87] are also common. In addition, common state-specific explicit waivers include waivers of defenses against assignees;[88] waivers of rights under valuation and appraisement laws;[89] waivers of the benefit of appraisal;[90] and waivers of confidentiality requirements.[91] These are just a handful of the numerous explicit waivers that are permitted by state and federal law and that are included in consumer credit origination, servicing, and collections documents.

In addition to these explicit waivers there are common implicit waivers of rights to legal recourse beyond the conflict of law provisions already discussed. Another example of a common implicit waiver relates to remedy and default terms providing that the lender does not waive any remedy by using another remedy, waive default by choosing not to use a remedy, or waive the right to consider an event a default if the default continues or occurs again. These common contractual provisions benefit consumers and lenders as they provide lenders with the protection and flexibility necessary to work with troubled borrowers. However, through these consumer default and remedy provisions, consumers implicitly waive any state law defenses they may have based on the lender's action or inaction in the event of default. Accordingly, they are prohibited under MLA.

Another example of an implicit waiver is a provision that gives lenders a right to take possession of collateral pledged to secure the loan. Virtually all security agreements used by depository institutions give the lender the right to take possession of the personal property or other collateral pledged to secure the loan without prior notice to the borrower in the event of a default on the loan. Pursuant to the Uniform Commercial Code, after default, a secured party "may take possession of the collateral

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85 *See* Uniform Commercial Code § 1-302.

86 *See* 12 C.F.R. § 227.13(b). *See also*, OCC's Comptroller Handbook, Other Consumer Protection Laws & Regulations, Credit Practices Rule (page 43): "Under the rule, a waiver is permitted if it applies solely to the property that was given as security in connection with the consumer credit obligation."

87 *See*, Uniform Commercial Code § 3-605.

88 *See e.g.*, Wis. Stat. § 422.407 permitting for consumer credit transactions.

89 *See e.g.*, Ind. Code § 34-55-4-1 *et seq.* and *Reily v. Burton*, 71 Ind. 118 (Ind. 1880).

90 *See e.g.*, La. Code of Civ. Proc. Articles 2332, 2336, 2723, and 2724.

91 *See e.g.*, Cal. Vehicle Code §§1808.21 and 1808.22, specifically authorizing financial institutions to obtain a written waiver of the California Department of Motor Vehicles' address confidentiality requirements.

[w]ithout judicial process if it acts without breach of the peace." [92] In relying upon the right to take possession, as provided in the security agreement and the Uniform Commercial Code, lenders routinely repossess collateral without requiring judicial process. However, the proposed prohibition against borrowers waiving their rights to legal recourse could drastically change and possibly eliminate lenders' ability to rely upon the legally permissible self-help repossession remedy, since it amounts to borrowers' waiving their right to judicial process and is thus a prohibited waiver of legal recourse. Elimination of this waiver will significantly increase a depository institution's recovery expense on defaulted loans, thus decreasing the ability of borrowers, including service members and their spouses and dependents, to obtain certain credit and increasing their costs.

As noted above, while a footnote in the proposal provides that the regulation does not impact federal laws governing interest rates, depository institutions would have to review and identify any and all other possible implicit and explicit waivers in their origination, servicing, and collections documents. Because MLA can be enforced by private right of action with its significant penalties, including voiding of the loan, there is significant incentive for class action counsel representing borrowers to make all of the arguments set forth above and presumably many others, limited only by the creativity of borrowers' counsel.

The expense to depository institutions to both identify any such explicit or implicit waivers and to then alter the numerous documents containing them would be astronomical. At a minimum, all depository institutions continuing to lend to military personnel and their spouses and dependents would have to identify all forms, agreements, and supporting documentation, which may be widely disbursed, review them to determine whether they contain any applicable waivers (both explicit and implicit), remove those waivers, consider the legal implications of that removal and make adjustments, then re-populate every form source with the revised forms. The sheer volume is impressive because it includes not only the actual note or agreement but ancillary origination, servicing and collections documents. To illustrate, one large bank reported that just for personal loans and lines of credit, it has over 750 origination forms in its library. This number does not include personal loan or line servicing, collection documents, education, or credit card documents. In addition, all depository institutions would also incur extensive costs to develop new processes to support the requirements of the previously waived provisions. Given the breadth of the task and sheer number of documents, it is virtually impossible to quantify the cost. Finally, the increased legal, regulatory, and reputational risk for depository institutions associated not only with the removal of these standard and permissible waivers but also with the form and process analysis and implementation could result in the outright elimination of entire consumer product sets. Consumers, including military personnel and their spouses and dependents ultimately bear the increased cost and are harmed by the reduced credit options.

A final illustration of the confusion invited under this cryptic prohibition is whether a customer's express consent under the Telephone Consumer Protection Act would be counted as a waiver of legal redress for autodialed fraud alerts or other permissible contacts where such consent is given.

The Department's estimate that the costs associated with this prohibition are "negligible" is completely divorced from reality and wholly without record to support.[93] The proposal fails to recognize or overlooks the widespread and permissible use of both explicit and implicit waivers in consumer credit documents and the important part they play in our robust and efficient consumer credit market. Also not considered is the profound and widespread downstream negative impacts that this proposed prohibition will have on the consumer credit market as a whole, on depository institutions, and, most

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92 *See*, Uniform Commercial Code § 9-609.

93 79 FR 58626 (footnote 177)

importantly, on individual consumers. It is another reason to exempt depository institutions from the regulation.

iv. Prohibition against unreasonable notices as condition for legal action and onerous legal notices in case of dispute

Sections 232.8(c) and (d) of the proposal also present requirements to comply with vague terms that create legal risk and liability and raise questions about the prudence and risk of continuing to lend to servicemembers and their spouses and dependents. Those provisions prohibit "onerous legal notice provisions in the case of a dispute" and "unreasonable notice from the covered borrower as a condition for legal action." Neither of the phrases are defined and the proposal provides no examples of what they might include. Indeed, the subtle distinction in their meanings adds to the uncertainty. What is the difference between "onerous legal notice provisions in the case of a dispute" and "unreasonable notice from the covered borrowers as a condition for legal action"?

The Department when it adopted the regulation in 2007 noted but dismissed concerns raised about the ambiguity of these phrases. It concluded, "in so far as necessary, the scope of the provision is more appropriately determined on a case-by-case basis."[94] This may have been appropriate and acceptable when the regulation only applied to a limited number of specific loans which were being targeted for their predatory practices and before the statute was amended to allow private rights of action. It is administratively irresponsible to impose a rule with which no lender can comply with reasonable certainty and leave them at the mercy of plaintiffs' attorneys ready to exploit the fuzziness of these terms.

The increased potential threat of meritless lawsuits that do not benefit servicemembers or their spouses or dependents but drive up what they and others pay and discourage lenders from lending to them as they do other customers in their markets or fields of interest is another reason to exempt depository institutions.

v. Arbitration

Proposed Section 232.8(c) also prohibits lenders from requiring covered borrowers to submit to arbitration. As the Department recognizes, this potentially increases lenders' exposure to litigation and additional costs.[95] While covered borrowers may represent a small percentage of the population, a depository institution that focuses on serving military personnel and their families may be particularly vulnerable to significant litigation costs, including those related class action suits, especially given the ambiguity in key terms of the proposal that make lawsuits attractive to plaintiffs' lawyers. The risk of increased litigation costs, especially related to class action suits, which often benefit the plaintiffs' lawyers more than individual plaintiffs, makes it more difficult and more expensive to lend to military personnel and their spouses and dependents.

It is also worth pointing out the benefits of arbitration, especially to servicemembers who are deployed away from their civilian homes or abroad, where they lack access to courts. To maintain their reputations and to keep their customers satisfied, depository institutions have every incentive to resolve disputes with their customers efficiently and fairly. The vast majority of disputes are resolved before the need for a formal process. For those that escalate, arbitration is a time-tested fair and typically quicker more convenient, and less expensive for the consumer than going to court, as outlined in various

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[94] 72 FR 50589 (August 31, 2007).

[95] 79 FR 58630. (September 29, 2014).

industry comment letters to the Bureau.[96] Unlike dispute resolution processes that require individuals to appear in person (and in court) to enforce their rights, arbitration can be conducted online, by phone, or by video conference, enabling servicemembers the ability to resolve disputes while they are deployed. Arbitration is often less expensive for the consumer as the arbitration administration fees are usually capped and much less than the typical court-filing fee.

Currently, as discussed in the industry comment letters to the Bureau, for individual cases, arbitration is often less expensive to the consumer -- and more expensive to the lender – than court. Thus, if pre-dispute arbitration agreements are prohibited, lenders are likely to eliminate entirely arbitration for individuals. This means that servicemembers and their spouses and dependents will lose access to arbitration and the associated benefits, a particular hardship when they are deployed away from their civilian home or abroad.

The Department has not offered any support or explanation for the need for such a prohibition for all consumer credit, either in the past or now. We also note that the Bureau is currently reviewing and studying arbitration, and that there is benefit to waiting for the results of its research and analysis before imposing a prohibition against mandatory for agreements with covered borrowers.

3. Timing of determination of applicability of regulation

The timing of determining military status is unworkable for consumer credit provided by depository institutions. In addition, the regulation does not specify how lenders may discontinue the special treatment afforded military personnel and their spouses and dependents when their status changes. The proposal provides in Section 232.2 that application of the regulation is determined by the borrower's status "at the time he or she becomes obligated on a credit transaction or establishes an account." As discussed earlier, most lenders, for practical and compliance reasons, will need to access the database at the time of application and then again when the loan closes, in order to comply with the regulation. For practical and compliance reasons, lenders will need to access the database at the time of application, either to determine eligibility or direct the applicant to a particular product or simply to identify the applicant as a person who must receive the required disclosures. They must again verify military status at the time the loan closes in order to comply with the regulation and, as noted above, to ensure that the use the correct set of loan agreements. Moreover, as also previously noted, it is not clear how a lender complies with regard to open-end credit, such as credit cards. Consumers typically do not become "obligated" on credit cards, for example, until the first transaction or a certain period after delivery of the card, as recognized under Section 1026.5.(b)(1) of Regulation Z. We do not know how lenders would be able to verify the customer's status at this time, as they have no control over when the customer decides to "accept" the account.

This complication is a compliance and liability trap and presents one more reason to exempt depository institutions.

As noted, the regulation does not address what happens when military status changes, e.g., when the servicemember leaves active duty, the spouse becomes divorced, or the dependent is no longer a dependent. To avoid abuse and inequity, the regulation should require covered borrowers to notify lenders when they are no longer eligible for the special treatment and specify that they may forfeit, at the lenders' discretion, any special treatment from the period during which they were ineligible. In addition, the regulation should specifically provide that if a lender learns of the change in military status,

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[96] See letter of the American Bankers Association, the Consumer Bankers Association, and the Financial Services Roundtable to the Bureau of June 22, 2012 and June 30, 2014.

it may close the account or make other appropriate adjustments. These compliance complexities and costs will make it more difficult to offer consumer credit loans, especially long-term open-end credit such as credit cards, to military personnel and their spouses and dependents.

4. Definition of consumer credit

While the proposal excludes from the definition of consumer credit most mortgages, it might inadvertently include some mortgage loans. Proposed Section 232.2(f) excludes residential mortgages, defined as "any credit transaction secured by an interest in the *covered borrower's dwelling*…" Thus, included in the provision are mortgages and other loans to servicemembers and their spouses and dependents which may be secured by someone else's dwelling, such as the dwelling of a parent or family member. In addition, it would cover mortgages for empty lots on which the servicemember or spouse or dependent plans in the future to build a dwelling. Even though such loans may be few in number, flagging them will add yet another level of complexity and risk to the already very complicated mortgage lending process that will discourage making these valuable options available. We do not believe that it was the intent to cover them. For these reason, we recommend that the Department revise the mortgage exclusion to reach all real-estate secured loans.

5. Mandatory loan disclosures

Section 232.6 of the proposal requires that all servicemembers and their spouses and dependents receive certain *oral and written* disclosures *before or at the time the borrower becomes obligated on the transaction or establishes an account for credit*. The following must be presented orally:

- "Statement of the MAPR" explaining that covered borrowers may not be charged more than the MAPR and describing the MAPR (Model language of 108 words provided);
- A "clear description of the payment obligation" of the borrower as applicable (payment schedule for closed-end or account-opening disclosures of pursuant to Regulation Z; for open-end); and
- A statement about financial protections and assistance for covered borrowers (111 words).

The proposal also requires that these disclosures also be provided in writing, along with the Regulation Z disclosures. For mail, internet, and point-of-sale transactions conducted with the sale of nonfinancial products, creditors may provide a toll-free number on or with written disclosures when the borrower contacts creditors for this purpose.

We believe that it is important that servicemembers and their spouses and dependents who struggle with their finances and need assistance and guidance have access to this information. There may, however, be ways to reach and educate them in a more meaningful and effective manner than the proposal would. While not as expensive as the need to retrieve and review both agreements and related documents to delete prohibited provisions, the cost is not negligible, contrary to the Department's belief.

Under the proposal, creditors will have to revise all consumer credit loan forms, including those on websites, to add language alerting servicemembers and their spouses and dependents to the statement of MAPR and the statement about financial protections and assistance to ensure compliance and simplify implementation. Thus, *all* borrowers will receive the disclosures, though they are irrelevant to the vast majority of borrowers. The additional notices will lengthen loan agreements which consumers, lenders, the Bureau, and consumer groups complain are already too long. The addition of irrelevant information tends to discourage people from reviewing the contract and important information.

We also suspect that it will be difficult in many instances to persuade covered borrowers to listen to the oral disclosures at the time an account is opened, especially if they are not in private setting. In addition, providing oral disclosures will require specialized training to ensure that the depository institution employee, at the right time, first, identifies the customer as a covered borrower, and then second, provides the oral disclosures. This is in addition to any other exceptional steps the employee must follow to comply with the regulation. The toll-free number is a better option, especially in the point-of-sale retail setting, but also in the bank and credit union branch setting, that will make it easier to continue to lend to servicemembers and their spouses and dependents.

The proposal permits, but does not require, disclosure of the MAPR. We agree with the Department that disclosures of the MAPR should not be required. The MAPR will confuse borrowers, especially when parallel to the APR, and will just influence them to ignore both.

VII. Impact on Small-dollar Loan Products

The proposal will clearly present another serious obstacles for banks' and credit unions' efforts to provide affordable small-dollar loans, efforts already hobbled by the FDIC and OCC Deposit Advance Product Guidelines and other practical and regulatory constraints. The MAPR cap, the other serious limitations of the regulation, and the process for identifying military personnel and their spouses and dependents will seriously hamper the ability to offer these loans. Yet, banking regulators and others have been coaxing banks and credit unions to offer such loans to provide a less expensive, more manageable alternative to nonbank loans such as payday loans and title loans – the very products MLA is intended to target -- and move users of those nonbank products into banks and credit unions to help them build overall financial health. Moreover, such loans are beneficial to military personnel and their spouses and dependents as an important complement to the military relief societies, which might not be an option in some instances or under some circumstances.

It will be challenging to make such loans without an exemption for depository institutions, in part because the MAPR may easily exceed the 36 percent MAPR cap. To be able to offer small-dollar loans, whether open or closed-end, it is often necessary to impose a fixed fee in addition to higher interest in order to recover costs. Fixed costs for small-dollar loans can be substantially similar to those for higher amount loans, but the interest earned is much less because of the lower loan amount of the loan. For example, ten percent interest per year on a $3,000 loan will earn $300 and on a $500 loan $50. If the lender's fixed costs are over $50, the $500 loan is unprofitable, so likely will not be offered or made. The terms on these loans tend to be shorter as well, so interest accrues for a shorter period. The cost is thus recovered through a higher interest rate or fixed fee or both for the smaller, shorter term loans. Products that consumer groups and banking agencies praise can easily get captured under the proposal and thus become unavailable to servicemembers and their spouses and dependents – or not made at all because of the cumulative burdens and complications of providing them.

The NCUA's Payday Alternative Loan as well as bank small-dollar affordable loan products, including some noted in the Department's April 2014 Report, illustrate. Some of those products include modest $20 to $35 application fees. One well-received affordable small-dollar line of credit program imposes a modest $25 annual fee. These fees are intended to recover some of the fixed costs. When calculated into the MAPR, the MAPR will quickly exceed the 36 percent cap. For example, a one-month $500 loan with a $20 application fee would reach 48 percent MAPR *before* interest is included in the calculation, and a $200 loan a 120 percent MAPR. The regulation thus will potentially put these products out of reach of servicemembers and their spouses and dependents and will also add to the challenges in continuing to offer these products.

While depository institutions continue their endeavors to make small-dollar products available, the FDIC's 2007 affordable small-dollar loan pilot demonstrates the challenges in making such loans (those up to $2,000) with an interest rate under a 36 percent interest rate, even with the additional revenue provided by non-interest fees. Under the FDIC's 2007 Affordable Small-Dollar Loan Guidelines[97] banks were encouraged to offer affordable small-dollar loans. The guidelines anticipate loans under $2,000 with APRs no greater than 36 percent. Reasonable origination fees are anticipated "to maintain a reasonable annual percentage rate (APR) and cover administrative and other expenses, and the guidelines recognize that other fees such as annual fees, advance fees, and membership fees may be necessary, though it encourages lenders to minimize or eliminate such fees. Yet, the results of the approximately 30 banks that participated in the FDIC's related affordable small-dollar loan pilot were disappointing.

The meeting of the FDIC Advisory Committee on Economic Inclusion held June 24, 2010 reported that such loans were not profitable. The CEO of one bank in the pilot, while enthusiastic about the program, "emphasized the importance of identifying alternative revenue sources to offset the higher costs of providing such loans."[98] FDIC staff, in reporting on whether banks can profitably offer small-dollar loans, offered no conclusion that the product could be profitable and instead focused on other aspects of the pilot.[99] In summarizing recommended incentives for banks to offer small-dollar loans, the FDIC included "loss sharing in the form of guarantees to offset loan losses" and Community Reinvestment Act credit,[100] strongly suggesting that profit is not anticipated for these loans.

The FDIC's report on its Small-Dollar Loan Pilot Program noted that banks in the pilot program found that "the interest and fees generated are not always sufficient to achieve robust short-term profitability. Rather most pilot bankers sought to generate long-term profitability through volume and by using small-dollar loans to cross-sell additional products."[101] Indeed, a few banks in the pilot "focused exclusively on building goodwill and generating an opportunity for favorable Community Reinvestment Act considerations,"[102] apparently not expecting the product to be profitable. Short-term profitability was the primary goal only for a few pilot bankers.[103]

In a striking illustration of the challenges in offering small-dollar affordable loan, a California thrift in 2013 shut down its small-dollar loan program, a program modeled on the FDIC Affordable Small-Dollar Loan Guidelines. The CEO of the thrift was quoted as saying in the *American Banker* that the reason for discontinuing the program was that it "lost too much money."[104] *Clearly, there are there are significant challenges in offering loans under $2,000 that will not exceed the proposal's 36 percent MAPR cap.*

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97 Federal Deposit Insurance Corporation. "Affordable Small-Dollar Loan Guidelines," June 2007.

98 Federal Deposit Insurance Corporation. "Minutes of the Meeting of the FDIC Advisory Committee on Economic Inclusion." June 24, 2010. p. 116.

99 *Ibid.,* p. 114.

100 *Ibid.,* p. 117.

101 Federal Deposit Insurance Corporation. "A Template for Success: the FDIC's Small-Dollar Loan Pilot Program." *FDIC Quarterly,* Vol. 4, No. 2; 2010. p. 32.

102 *Ibid.*

103 *Ibid.*

104 *See* "California Thrift's Woes Show Challenges Competing with Payday Lenders," May 2013.

Banks continue to try to design small-dollar loans that will meet the needs of those who do not qualify for mainstream loans, such as credit cards, that otherwise provide small-dollar, reasonably priced credit. The proposal, however, will erect an additional and significant barrier.

First, as the FDIC pilot suggests, it will be difficult to stay below a 36 percent MAPR due to any origination or membership fee, even a modest one. Second, the costs associated with the proposal, including those related to identification of covered borrowers, prohibitions on certain terms, as well as the risks and potential liability associated with compliance, increase the costs of the depository institution. This will increase the loan price, which means that it is more likely that the small loan will exceed the 36 percent MAPR. If the price does not cover the increased costs, the small-dollar loan product is unsustainable. Add to the equation the other barriers to providing small-dollar loans, including the Banking Agencies' Deposit Advance Guidance, and practical, economic, and business considerations, and depository institution small-dollar loans depository institutions become untenable.

We understand and support the Department's substantial efforts to minimize the need for military personnel and their spouses and dependents to obtain small-dollar loans, especially predatory loans. We applaud the Department's very pro-active efforts to provide financial counseling and programs to promote financial literacy, prudent financial planning, debt elimination, and wealth building. In addition, we commend the Department's support of servicemembers and their spouses and dependents through its direct and indirect financial assistance through military relief societies which offer no-interest loans for shortfalls in household expenses and for unforeseen emergencies as well as grants and scholarships. While such assistance is beneficial and appropriate, it is not always an option and does not always work as hoped. Therefore, it is important that mainstream, private options are also available as a necessary complement to military options.

As we believe the Department recognizes, some military personnel and their spouses and dependents are reluctant to use military relief societies because of the perceived stigma and link to military command. The Department reports that the assessment by those using payday loans of their financial options:

> May be influenced by their perceptions that choosing to apply for other less financially costly loans from military sources would not be approved, would require them to divulge additional information about their finances, or place themselves in a situation where their previous financial choices were going to be called into questions…Most felt that they would be embarrassed obtaining a loan from the military relief societies and half felt that their commanders would find out (another third were uncertain).[105]

In addition, those options from military relief societies may not be available near all bases. For the reasons cited above, some seek out quick, convenient, and anonymous alternatives such as payday lenders. Moreover, while the Department wants to simply cut-off those options, it may be overly optimistic about its capacity to meet the potential demand for assistance. In any event, small-dollar loans and other mainstream loans offered by banks and credit unions and those offered through military relief societies are not one to the exclusion of the other. Indeed, the ability to understand and manage mainstream products offered through depository institutions serves servicemembers and their spouses and dependents in the long term as it better prepares them for life outside the military, where financial assistance and guidance is less visible or available.

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[105] Department of Defense, "Report: Enhancement of Protections on Consumer Credit for Members of the Armed Forces and Their Dependents" (August 2014), p. 12.

Finally, a reminder of the concerns that prompted both the original MLA and the proposed revisions efforts to update the proposal is instructive. The goal of both is to prohibit servicemembers and their spouses and dependents from relying on inappropriate sources of credit such as payday lenders and vehicle title lenders. Those types of lenders, however, are the ones who have attempted to evade the MLA restrictions. Yet, the proposal will make it more difficult for mainstream lenders, especially depository institutions, to offer alternatives to these types of loans, making it more likely servicemembers and their spouses and dependents are to turn to predators who will continue to find new and innovative ways to provide attractive but inappropriate products.

VII. Underestimation of costs

Generally, the Department grossly underestimates the intrinsic costs of the expansion in coverage of the proposed regulation as well as the cost of particular provisions. The analysis underestimates not only the cost of the minimum and limited factors it has identified but also overlooks significant costs associated with other provisions of the proposal that the Department has claimed will have minimal cost impact. Similarly, costs are underestimated because it has overlooked many of the depository institutions' products that the regulation will now capture. The analysis neglects many of the up-front costs but especially the continuing costs of compliance, and underappreciates the culture of compliance in depository institutions that strives for zero tolerance in violations and that demands an associated caution when implementing regulations, a sensitivity made more acute because of the consequences for a MLA violation. We also note that the Department's analysis seems to be from the perspective of large institutions and somewhat insensitive to small and mid-sized lenders who lack the resources that the largest institutions might have in order to analyze the regulation and delve into all implications. Finally, these costs and concerns should not be casually dismissed with assumptions that lenders will simply figure it out and pay. They have a real impact on what loans are available to consumers, servicemembers and their spouses and dependents and what they pay.

In discussing the cost estimates, the Department recognizes the credit card product, but it seems to ignore the list of other depository loan products that are covered, including overdraft lines of credit, open and closed-end credit, car and other personal property refinance loans, liquid secured loans, and student loans, most of which are basic products for depository institutions of all sizes. The Department does not include in its estimates any of the costs associated with coverage of these loans. Yet, as discussed, all of those products will have to be examined to determine whether they comply with the MAPR cap and adjustments made. *All* contracts will have to be reviewed, revised, and replaced. Compliance for open-end credit products may entail significant systems and operations changes. All new products will have to be designed around the regulation and reviewed for compliance. Depository institutions will have to comb through websites. All lenders will have to integrate their systems with the MLA database. Staff training materials will have to be revised. Staff, including those tasked with accessing the database and reading disclosures to customers, as well as customer representatives handling inquiries, will have to be trained, not only when the regulation goes into effect, but on a continuing basis. For depository institutions, there are costs with bank examiner review as well as preparation for the review. The MLA rule will be added to the long list of regulations that credit union and bank staff must know and implement.

The Department focused its cost analysis on the disclosures and access to the database as they "are reasonably likely to impose costs." It concluded that others cost are either minimal or not "amenable to measurement." [106]

[106] 79 FR 58626 (September 29, 2014).

The Department significantly under-estimates the cost of accessing the database and retaining and retrieving a record of the results of the query. It acknowledges that all creditors offering consumer credit will have to establish processes for querying the MLA database and retaining records[107] but underestimates the frequency and volume of those inquiries. It expects there to be 70 million inquiries per year.[108] However, as discussed in our section on the identification of borrower, the number is more realistically closer to a 400 to 600 million range, potentially almost ten times the Department's estimate.

In addition, the Department does not take into account the costs incurred when the MLA database will be down, which, given the experience with the much less used SCRA database, we can expect not to be unusual. This means systems and procedures have to be implemented to set aside and recover applications and loan approvals for later queries, to notify applicants potentially, etc. There are also costs associated with integrating the MLA database with the lenders' database that ensures the security and protection of both, especially given the private and personal nature of the information involved with both databases.

The Department minimizes the impact of the MAPR calculation and cap, on the assumption that most products will not exceed the 36 percent MAPR. It acknowledges that a creditor "who chooses to extend credit with a cost that may exceed the interest-rate limit [i.e., the MAPR, which, as discussed, is distinct from interest]… might need to adjust its computer and software systems to calculate the MAPR, develop new policies and procedures, and train staff on new procedures for identifying covered borrowers and taking advantage of the proposed safe harbor…."[109] The Department's assumptions are unrealistic.

First, it appears to anticipate credit cards only and not products typical in all depository institutions, such as other types of lines of credit. Those products are not entitled to the bona fide fee exemption, even if it were usable. It appears that the costs of reviewing, adjusting, and implementing systems to calculate the MAPR and waive fees exceeding the MAPR cap or abandoning those products have not been considered.

Second, the Department assumes that most loans will not exceed the 36 percent MAPR, which as discussed, will not be true. Lines of credit and affordable small-dollar loans are examples. It also assumes that most credit cards will be able to avoid the MAPR cap through use of the bona fide fee exemption. As discussed, that exemption is essentially illusory, so the Department should not rely on it in its analysis of costs. Instead, the Department should assume that card issuers, including all the community banks, small credit unions, and mid-sized regional banks that offer credit cards, will have to devise a means of segregating accounts of servicemembers and their spouses and dependents, devising systems that can calculate the MAPR and then waive amounts in excess of the MAPR cap, all in time to provide the monthly statement. The Department should also consider that the cost is actually higher than just implementation of one discrete systems change because the MLA-related changes will necessarily disrupt information technology schedules, which have cost repercussions. While we do not have exact costs, implementing, running and maintaining a shadow control process for MAPR compliance will be in the millions of dollars for the larger banks and a comparably expensive redundancy for community banks.

The Department also assumes that the other limitations of the proposal will have no or minimal costs.

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107 *Ibid.,* p. 58629.

108 *Ibid.,* p. 58630.

109 *Ibid.*, p. 58626.

> For example, the Department believes that the costs associated with the prohibition against requiring a covered borrower to waive his or her rights under an otherwise applicable provision of law…is not material to this regulatory impact assessment because the potential costs of this prohibition are negligible. Moreover, there is no reasonable basis for the Department to estimate the potential costs associated with this prohibition, in part because the Department believes so few – if any – creditors currently requires…a consumer to waive rights under applicable provisions of State or Federal law.[110]

However, as discussed, most consumer credit agreements do, in fact, contain such waivers. Creditors continuing to lend to servicemembers and their spouses and dependents will have to retrieve, review, and replace all consumer credit agreements – as well as all the ancillary agreements. One bank reported that it has six basic agreement and approximately 180 ancillary original documents in its library. The number of documents to review, revise, and replace will be multiplied if the depository institution offers forms in other languages. In addition to the costs of revising documents, there will be a cost impact if the waivers are removed, though we cannot offer estimates. Those costs should be acknowledged.

Similarly, as the Department recognizes, forms will have to be revised to add the required MLA notices. While adding model language is not as labor-intensive and costly as reviewing entire documents and analyzing and revising various provisions, there are costs for every depository institution, including small and mid-sized institutions.

The Department properly recognizes the existence of costs related to the prohibition against arbitration, but fails to recognize how the regulation itself will attract class-action suits, which will exacerbate the cost impact of that provision. However, it is difficult to provide an estimate of that cost.

VIII. Effective Date

The proposal does not include the time period lenders will have to comply. Previously, the Department only allowed 30 days. Given the breadth, complexity, and broad reach of the proposal, the necessary legal analysis operations, systems changes, staff training, the draconian consequences for violations, the effective date would have to be far longer. In addition, the systems changes, such as those involving MAPR calculation and MLA database access must be tested, adjusted, and re-tested. To ensure all depository institutions, including community banks and small credit unions, have sufficient time to ensure compliance by either conforming available products to the new requirements or accurately identifying credit products to be eliminated from those offered to servicemembers and their spouses and dependents, the Department should allow lenders at least 18 months to comply.

IX. Conclusion

The Associations appreciate the opportunity to comment on this important and far-reaching proposal that will greatly impact servicemembers and their spouses and dependents as well as all depository institutions. If adopted, all military personnel and their spouses and dependents, including the vast majority who manage their finances well, risk losing access to beneficial and valuable mainstream products and being ineligible for new products. These products include not only, for example, popular credit card products, but also small-dollar affordable loans. Moreover, the proposal will impact the population as a whole, because it will stifle development of new, innovative products

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110 *Ibid.*

and erect yet another barrier to offering small-dollar affordable loans, products depository institutions are encouraged to provide as alternatives to the very predatory loans the MLA was intended to target.

The proposal will also require all lenders offering consumer credit to servicemembers and their spouses and depend to inquire with the Department's MLA database to determine military status of *every* consumer credit application. Consumer credit lending will come to a halt when that database is unavailable. Given the frequency of the current problems with the availability and accuracy of the Department's SCRA database and the exponential increase in the volume of inquiries, we can expect regular delays in the approval of consumer credit.

While we appreciate the Department's efforts to make accommodations for credit cards (but not other consumer credit) with regard to the MAPR calculation, the exemption from the MAPR calculation of "reasonable and customary" fees simply is unworkable. Moreover, even if a lender could comply with the MAPR cap, the prohibitions of other vague and subjective terms make continuing to offer consumer credit to servicemembers and their spouses and dependents prohibitive. We are also concerned that the proposal will mean that military personnel will lose the option to have disputes handled through arbitration, a fair, quick, and convenient option, especially for servicemembers away from home or abroad. In addition, the Department grossly underestimates the costs of the proposal and the impact on depository institutions of all sizes.

We strongly encourage the Department to make appropriate adjustments to address efforts at evasion and protect servicemembers and their spouses and dependents from predatory loans. It should do so, however, in a targeted fashion, consistent with the history and intent of the MLA. To achieve these goals, we believe the regulation should exempt depository institutions, who, as demonstrated, are not the source of problems to servicemembers and their spouses and dependents and who are regularly examined for compliance with consumer protection laws.

We are happy to discuss this matter further and to provide additional information. Please contact Nessa Feddis at 202 663 5433 (nfeddis@aba.com).

American Bankers Association

Independent Community Banks of America

Association of Military Banks of America

National Association of Federal Credit Union

Consumer Bankers Association