

The Honorable Dr. David S.C. Chu
Under Secretary of Defense
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Washington, D.C. 20301-4000

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The undersigned trade associations representing insured depository institutions appreciate the opportunity to offer our views on the implementation of Section 670 of the John Warner National Defense Authorization Act for Fiscal Year 2007, Pub. L. 109-364, Section 670, "Limitations on Terms of Consumer Credit Extended to Servicemembers and Dependents" (hereafter, "Payday Law"). The Payday Law is intended to remedy abusive practices associated with payday lending to military personnel as identified in a recent Department of Defense study, "Report on Predatory Lending Practices Directed at Members of the Armed Forces and Their Dependents," dated 9 August 2006 (the "Department of Defense Report"). The language of the Payday Law could be read to impose a new scheme of rate regulation, loan feature limitations, and disclosure requirements for a broad array of credit products offered to military personnel, their spouses, and their dependents.

Among the provisions are restrictions against using direct debit to repay a loan, prohibition against refinancing a loan the lender originally made, limitations on interest rates, requirements to provide oral disclosures, and restrictions on lenders' legal remedies. The Secretary of Defense is responsible, in consultation with the federal depository institution regulatory agencies, specifically, the Federal Reserve Board, Office of the Comptroller of the Currency ("OCC"), Federal Deposit Insurance Corporation, ("FDIC"), the Treasury Department, the Office of Thrift Supervision, National Credit Union Administration, and the Federal Trade Commission, for prescribing regulations to implement the Payday Law.

Our primary concern is that a broad application of the legislation could have the unintended effect of harming servicemembers and their spouses and dependents by limiting their access to beneficial and common credit products or increasing their credit costs. For these reasons, we strongly recommend that the Secretary apply the regulation narrowly to ensure military personnel and their spouses and dependents continue to have access to these useful products.

We have divided our letter into five parts:

- 1) Executive summary;
- 2) Overview;
- 3) Background and summary of the Payday Law;
- 4) Discussion; and
- 5) Conclusion.

A description of the undersigned trade associations is also attached.

I. Executive Summary

- The banking industry has an established history of effective cooperation with the military services—supported by a track record of delivering financial services fairly and promoting the responsible use of consumer credit for the benefit of our nation’s armed servicemembers and their families. In keeping with this tradition, the banking trade associations pledge our energies to the effective resolution of the issues we believe the Payday Law was intended to address.
- To ensure that the Payday Law is implemented, as you note in your November 2006 letters to the American Bankers Association and the Independent Community Bankers of America, “without creating unintentional limitations on Servicemembers and their families obtaining favorable credit products,” we believe that the most effective approach is to focus on payday loans, that is, certain small, short-term loans that are also covered under the Truth in Lending Act’s implementing regulation, Regulation Z.¹
- To avoid the unintended consequences to military personnel and their spouses and dependents and to avoid undermining the safety and soundness of insured depository institutions, it is critical that the regulation clarify that the regulation does not cover loans and accounts in existence prior to the effective date of the regulation. Otherwise, many loans to military personnel or their spouses or dependents (e.g., ones paid by use of direct debit) could become illegal upon the effective date of the Payday Law, subjecting insured depository institutions to severe losses.
- The regulation should provide that eligible credit applicants would have the responsibility to identify and verify their eligibility with documentation upon request. Lenders should be able to easily confirm applicants’ eligibility, for example, by submitting inquiries to an expanded Department of Defense’s Defense Manpower Data Center that includes the names of eligible spouses and dependents.
- The definition of consumer credit should be limited to certain small, short-term loans, so that military personnel and their spouses and dependents do not lose access to popular, convenient, and common credit products and terms. A few examples of the many implications include the following:
 - Military personnel and their spouses and dependents may no longer have available to them loans that offer incentives such as lower

¹ Regulation Z, promulgated by the Federal Reserve Board, covers payday loans.

interest rates or other favorable terms in exchange for agreeing to repay the loan through automatic payments from their checking account (“direct debit”).

- They will be less likely to open a savings account when they obtain a loan because the prohibition against using a savings account as security for a loan means savings accounts are less likely to be linked to affordable small loan programs offered by depository institutions.
- Products that are more often offered by mail, Internet, and telephone rather than in person will be less available to military personnel and their spouses because providing oral disclosures, as required by the Payday Law, is not feasible or practical in these circumstances.
- Military personnel and their spouses and dependents will not be able to take advantage of lower rates or better terms that are frequently offered when refinancing with an existing lender. Nor will they be able to participate in work-out loans with their existing lenders.
- Interest rates and possibly fees on loans to military personnel and their spouses and dependents cannot be lowered once the account is opened.
- The importance of a narrowly applied regulation that clearly targets payday lending is critical, as underscored by the severe penalties for violations. These include potential imprisonment and voidance of the contract from inception, which rarely if ever are present in consumer protection banking laws. Given the severity of the sanctions, depository institutions will be excessively cautious to avoid any possibility of infringing the regulation in any particular. Absent a narrow application of the Payday Law, military personnel and their spouses and dependents could find their choices for financial products and terms from depository institutions and other reputable financial institutions and lenders extremely limited as lenders give wide berth to anything that could even inadvertently put them at odds with the regulation and subject them to sanctions.
- Unless narrowly applied, military personnel and their spouses and dependents trying to compare and understand credit costs would likely find credit term disclosures confusing and effectively meaningless when they are presented with two different annual percentage rates based on different sets of definitions for the same credit product.
- In addition to carefully focusing the definition of consumer credit on certain small, short term loans – the abusive payday loans -- the Secretary should rely on the definitions of key terms such as “consumer credit” and “creditor” found in the Truth in Lending Act’s Regulation Z to avoid ambiguity and unintended consequences and to ensure clarity.

II. Overview

The banking industry has an established history of effective cooperation with the military services—supported by a track record of delivering financial services fairly and promoting the responsible use of consumer credit for the benefit of our nation’s armed servicemembers and their families. In keeping with this tradition, the banking trade associations pledge our energies to the effective resolution of the issues the Payday Law was intended to address.

We appreciate that you are striving, as stated in your letters to the American Bankers Association and the Independent Community Bankers of America, to implement the Payday Law “without creating unintentional limitations on Servicemembers and their families obtaining favorable credit products.” Unfortunately, if not implemented carefully, the law could have the undesirable effect of harming military personnel and their spouses and dependents by making certain credit products and credit terms unavailable to them and raising their credit costs.

To avoid these unintended and harmful effects for military families, we think that the most effective approach for the Secretary to implement the Payday Law is to focus on payday loans, that is, certain small, short-term loans that are covered under the Truth in Lending Act’s implementing Regulation Z. We hope to work closely with the Secretary in developing the specific features and terms of loans to be covered by the regulation so that military personnel and their spouses and dependents continue to have access to beneficial, popular credit products available to civilians.

The Payday Law, while aimed at a narrow set of abusive transactions, has the potential to deprive military personnel and their spouses and dependents of the benefits of a number of legitimate, popular, and helpful products. These include:

- student loans;
- credit cards;
- personal unsecured loans;
- mortgage refinancings;
- loans secured by 401(k) plans;
- loans secured by insurance policies;
- work-out loans;
- overdraft lines of credit; and
- margin loans.

Below are some examples of the potential consequences to military personnel and their spouses and dependents.

- Pursuant to the provision prohibiting using access to an account as security for a loan, military personnel and their spouses and dependents might not be eligible for products that offer lower interest rates and other favorable terms in exchange for agreeing to repay the loan using direct debit (i.e., automatic payment from a checking account).
- The same provision that prohibits using access to an account as security for a loan could inhibit depository institutions from encouraging military personnel and their spouses and dependents to set up a savings account and arrange regular contributions at the same time they obtain a covered loan -- programs that military banks, in particular, have been encouraged by the military to offer.
- Military personnel and their spouses and dependents could be prohibited from refinancing an existing loan with the same lender, even when doing so is in their best interest, e.g., work-out loans or loans with lower rates.
- Military personnel and their spouses and dependents may lose access to popular products such as credit cards due to the fact that even a modest fee imposed in a particular month where there is a small balance may surpass the “all-in” 36% annual percentage rate limit when calculated on an annual basis.
- For the same reasons, military personnel and their spouses and dependents may also lose access to overdraft protection. As a result, they might have their checks returned to a merchant or other payee rather than paid when there are insufficient funds in an account. The result may be returned check fees imposed by the merchant, inconvenience, embarrassment, and adverse information on reports about their financial history.

As we explain in greater detail later, there are also a myriad of practical considerations, operational challenges, and significant compliance burdens imbedded in the requirements if the Payday Law is applied broadly. Top among the practical challenges is how to determine, verify, and monitor applicants’ eligibility so that lenders may comply. Other significant challenges include developing a new calculation of annual percentage rate (“APR”) distinct from the APRs required for several decades under the Truth in Lending Act, and delivering oral disclosures in a practical manner that is meaningful to the covered borrower – particularly in cases where financial transactions do not take place in a face-to-face context.

The compliance burdens and need to segregate applications and loans by type of borrower will demand installation of new software and related systems. Even if feasible, it may be prohibitively expensive, especially for small depository institutions. These costs alone could make it impractical to continue offering

many credit products military personnel and their spouses and dependents enjoy today. A narrow application of the Payday Law will minimize these burdens.

The importance of a carefully focused regulation with objective definitions and instructions that clearly targets payday lending is critical, as underscored by the severe penalties for violations, penalties that are rarely if ever associated with consumer protection banking laws. Penalties under the Payday Law include potential imprisonment for “knowing” violations, fines, and voidance of the contract from inception. ***The effect of these sanctions is impossible to overstate.*** Their severity makes lending to military personnel and their spouses and dependents extremely risky.

Concern about imprisonment is obvious. Among regulated depository institutions that rely on their reputations and public confidence, a criminal indictment, even for a misdemeanor, is likely to undermine the public confidence on which the success of depository institutions rest, seriously challenging the continued viability of the institution.

Voidance of the loan creates the potential for significant safety and soundness risks to insured depository institutions, as they can be liable to forfeit the entire principal of the loan and any fees and charges. Such damages could have a material adverse effect on the insured depository institution, especially when multiplied in potential class action suits, presenting serious safety and soundness risks. Moreover, insured, regulated depository institutions have the additional pressure of bank examiners’ reviews, interpretations, and remedies. Given the potential consequences, regulated depository institutions would have to avoid any risk of misinterpreting a subjective provision and err on the side of caution. Absent a narrow application of the Payday Law, military personnel and their spouses and dependents could find their choices for financial products and terms from insured depository institutions and other reputable financial institutions and lenders very limited.

It must be stressed that the banking industry remains eager to fulfill our responsibility to members of the military and their spouses and dependents by helping to eliminate the abusive practices noted in the Report. We are therefore anxious to work closely with the Secretary to ensure that the regulation is implemented in an effective, workable manner that addresses the problems associated with payday lending without depriving military personnel and their spouses and dependents of valuable, important bank products that are readily available to the civilian population. For these reasons, we strongly recommend that the Secretary use his authority to define “consumer credit” to limit application of the regulation to certain small, short term loans, that are also covered under Regulation Z, the regulation that implements the Truth in Lending Act. We hope to work with the Secretary to develop the specific parameters of the definition of consumer credit.

III. Background and Summary of Payday Law

The original payday lending amendment agreed to on the Senate floor was much narrower than the legislation ultimately passed by Congress. In essence, it capped interest on loans to military personnel and their spouses and dependents. In conference, however, the amendment was significantly expanded in an effort to address specific concerns related to predatory lending contained in the Department of Defense Report that concluded that predatory loans, including payday loans, were undermining military readiness. 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 unintended consequences were not considered.

The Payday Law's restrictions and requirements, as enacted, apply to certain loans provided to military personnel on active duty or "on active Guard and Reserve Duty" and to the member's spouse, child, and anyone for whom the member provided one half of the person's support in the 180 days preceding extension of credit. The Payday Law covers consumer loans to military personnel, except purchase money loans (that is, loans secured by property, such as a car, to be purchased with the loan) and "residential mortgages." The primary provisions:

- **Prohibit refinancing with the same lender.** Lenders are prohibited from refinancing covered loans with military personnel, their spouses, and their dependents, even if the terms of the new loan are beneficial or useful to the borrower.
- **Prohibit the use of checks or bank account access as security.** Presumably intended to prevent the rollover of loans in the payday lender context, the Payday Law could make unavailable to military personnel and their spouses and dependents loans that offer lower interest rates and other favorable terms in exchange for agreeing to make payments through direct debit from a checking account. It also means savings accounts cannot be used as security for a loan.
- **Impose a cap on the "annual percentage rate of interest."** The Payday Law limits the annual percentage rate ("APR") on covered loans to 36%. However, unlike the current APRs disclosed to all consumers under the Truth in Lending Act and its implementing Regulation Z, the Payday Law APR includes all fees associated with the loan.
- **Require loan disclosures.** Additional disclosures and Regulation Z disclosures have to be provided both in writing *and orally*. Both the Truth in Lending Act APR and the Payday Law APR must be disclosed.
- **Prohibit changes in interest rates.** The Payday Law prohibits a lender who extends consumer credit from requiring the consumer to pay interest

except as agreed to under the terms of the credit agreement. This means interest cannot be lowered once the account is opened.

- ***Prohibit the waiver of rights.*** Lenders may not require borrowers to waive their right to any legal recourse under any other applicable provision of state or federal law.
- ***Prohibit certain terms.*** The amendment prohibits arbitration clauses and “onerous legal notice” provisions, to be defined by regulation.

IV. Discussion

Application to existing loans: It is critical that the regulation exempt loans and accounts in existence prior to the effective date of the regulation.

A key question the regulation must resolve is whether the provisions apply to loans and accounts existing before the effective date of the statute. The language of the statute does not specifically address whether existing loans are covered. For the reasons discussed below, we believe that the regulation should specifically exclude from the definition of consumer credit loans and accounts in existence prior to the effective date.

Protection for loans made and accounts opened prior to active duty is already provided by the Servicemembers Civil Relief Act (“SCRA”). That law states that “an obligation or liability bearing interest at a rate in excess of 6 percent per year that is incurred by a servicemember or the servicemember and the servicemember’s spouse jointly, before the servicemember enters military service shall not bear interest at a rate in excess of 6 percent per year during the period of military service.” (50 U.S.C. App. Section 527.)

The maximum interest permitted under the SCRA is 6%, much less than the limit under the Payday Law’s section 987(b). Thus, at least with regard to loans made and accounts opened prior to active duty, arguably, it is better for a servicemember to take advantage of the 6% limit in SCRA than the 36% “all-in” limit of the Payday Law.

However, regardless of the SCRA, unless existing loans and accounts are excluded from coverage of the Payday Law, loans made and accounts opened after the servicemember has gone on active duty will be covered, and the other provisions of the Payday Law, such as the prohibition against refinancing with the same creditor and restrictions on direct debit, would still apply to existing loans and accounts.

Furthermore, we respectfully suggest that retroactive application of the Payday Law would be unworkable. Lenders would have to determine whether any of their millions of existing borrowers are eligible. Even if the regulation were

to establish a workable means for determining eligibility under the Payday Law for new loans, it would be impossible as a practical matter to determine coverage for existing loans and accounts, given the huge volume and lack of any automated system to do so. Simply determining eligibility would require a review of *each and every* consumer loan in existence. And even if it were feasible to determine eligibility of existing customers, lenders would then have to undertake a massive project to adjust the terms of those existing loans and accounts, e.g., eliminating direct debit for certain loans and recalculating the APR according to a new formula and related software that has yet to be designed. In some cases, the only choice may be to terminate the credit. It is very possible that revocation of some of these beneficial features could impose on customers significant disruptions and hardships. Moreover, all this would likely have to be accomplished by the 1 October 2007 effective date.

Given the obstacles for identifying eligible borrowers, the problems associated with adjusting their existing loans and accounts, and the severe penalties for violations, we suggest that the regulation limit application of the Payday Law to loans and accounts originated after the effective date of the regulation.

Eligibility: scope of who is covered. The regulation should provide that eligible credit applicants would have the responsibility to identify and verify their eligibility with documentation. Lenders should be able to confirm applicants' status, for example, by submitting inquiries to an expanded Department of Defense's Defense Manpower Data Center that includes the names of spouses and dependents..

Among the most critical and challenging issues to resolve, especially if the provision is not narrowly applied, is a means for lenders to 1) determine, 2) verify, and 3) monitor eligibility for coverage under the provision of a broad range of individuals and their family members and dependents whose military, marital, and dependent status may be uncertain or not readily evident to the lender or which may change over time. Given the severe penalties for providing a prohibited product or term to servicemembers or their spouses or dependents, it is imperative that the regulation provide an easily-applied, effective, and manageable means for lenders to identify and confirm eligibility so as to give the lender a "safe harbor" for compliance.

Currently, for purposes of the SCRA, active duty servicemembers volunteer information about their status and provide documentation confirming their active duty status.² Depository institutions may confirm eligibility and monitor

² Under the terms of the statute, to take advantage of this provision, "a servicemember shall provide to the lender written notice and a copy of the military orders calling the servicemember to military service and any order further extending military service, not later than 180 days after the date of the servicemember's termination or release from military service." 50 U.S.C. App. Section 527(b)(1).

for continuing eligibility by submitting an inquiry to the Department of Defense's database, the Defense Manpower Data Center ("DMDC").

Even if the Secretary were to use this model for the Payday Law, there are significant challenges applying it for purposes of the Payday Law. A primary one is identifying "dependents." We suggest that the regulation provide that eligible applicants are responsible for alerting the lender of their eligibility, as they are under SCRA.

An alternative might be to include an inquiry in an application form, but this presents its own problems. First, requesting information about marital status in order to determine whether the applicant is a spouse of a servicemember may violate the Equal Credit Opportunity Act ("ECOA").³ Specifically, the regulation implementing that law, Regulation B, generally prohibits lenders from inquiring about the marital status of a person applying for individual, unsecured credit.⁴ In addition to regulatory sanctions, lenders that violate ECOA are subject to actual and punitive damages.

Second, it is not clear how this would work in situations where applications are transmitted via a third part (such as a retail store). In this situation, no field exists to transmit the eligibility information.

Third, it is not immediately practical to insert on application forms an inquiry about eligibility under the Payday Law given the short period of time before the law's effective date. Requiring that application forms contain an inquiry will require revising application forms, retrieving noncompliant ones in circulation (which in some cases means throughout the country), redistributing the new forms, and training staff on their use, all by the 1 October 2007 deadline. This is simply not feasible. Even if lenders were able to do so, invariably, old applications from a prior mailed solicitation or old "take-one" credit card applications obtained from a place of business might still be submitted.⁵ Plaintiffs would assert that it was a "knowing" violation on a variety of bases (e.g., the lender should have followed up with a telephone call or the lender did not exercise sufficient due diligence in replacing all applications), subjecting the lender to the Payday Law's most severe penalties. For these reasons, we strongly recommend that the regulation provide that it is applicants' responsibility to bring their eligibility to the attention of the lender similar to what is required under the SCRA.

³ 15 U.S.C. 1601 *et. seq.*

⁴ 12 CFR 202.5(d)(1)

⁵ This raises another set of problems with handling non-compliant application forms after the Payday Law becomes effective. If quick processing of loan applications is one feature that makes existing payday loans appealing to servicemembers, servicemembers may be more likely to turn to payday lenders if an application is delayed because the application form has to be processed through alternate channels to ensure compliance with the Payday Law.

In addition to having applicants volunteer to lenders that they are eligible under the regulation, the regulation and the Department of Defense should provide a mechanism for lenders to easily verify an applicant's eligibility. It is our understanding that currently no lender-accessible database exists that contains every person who would be a "dependent" for purposes of the Payday Law. Absent the creation of such a database by the Department of Defense, lenders will be required to find some alternative means for verifying dependent status with each individual who applies for credit. From a practical perspective, in today's environment where consumers expect quick applications and responses and where a face-to-face application for consumer credit is an increasingly rare event, it is not reasonable to expect depository institutions to be able to interview the servicemember and/or dependent, and then review documentation, such as tax records, which would be necessary in order to determine whether a person is a "dependent" within the timeframe that a customer is likely to allow for such a transaction. The customer is likely to leave in frustration and conduct business with a less scrupulous provider of funds. Accordingly, we believe that some kind of military document showing status and a database verifying status are the only workable options.

Our understanding is that some family members of the servicemember are eligible for an optional military identification card. A simple and workable approach would be for the regulation to limit the definition of dependents to those eligible for such identification and allow lenders to require that such documentation be presented in order to be considered eligible.

With regard to the use of a database, if the Secretary were to use the DMDC model, certain operational challenges would need to be addressed. First, the DMDC would have to be upgraded to include information on eligible spouses and dependents to allow lenders to monitor for *continued* eligibility. In addition, given that the broader application of the Payday Law compared to SCRA may vastly increase the volume of inquiries, the Department of Defense should also modify the DMDC to allow for inquiries to be submitted in batch form. It is our understanding that the DMDC currently does not permit batch inquiries, with the result that lenders must submit inquiries one application at a time. This is a costly, time-consuming task if large volumes are involved since each one must be processed individually. Furthermore, it will be critical that the database be easily accessible to lenders in a secure environment and with sufficient capacity to handle the large increase in the volume of inquiries.

The Payday Law extends its protections through the definition of "Covered Member" to include a member of the armed forces who is ". . . (B) on active Guard and Reserve Duty." This reference to "active Guard and Reserve Duty" appears in 10 U.S.C. 101(d)(6)(A). We assume that this language in Title 10 defines the application of the Guard and Reserves for "Covered Member" under the Payday Law. As such, it would appear that the Payday Law also applies to members on active duty and to members of the Army and Air National Guard on full-time National Guard duty.

We suggest that the Payday Law exclude from coverage those Guard and Reserve members who are not on active duty for purposes of SCRA as well as members of the Army and Air National Guard who are on full-time National Guard duty. There is no central database, such as DMDC, available to verify duty status for these people. If they are not excluded, depository institutions will be confronted with insurmountable compliance burdens if there were no effective and easy mechanism to verify Guard and Reserve status where the individual is on full time service to the Guard or Reserves but does not appear as an active duty servicemember. It would be practically impossible to contact every state Guard governing authority to determine who is on active Guard and Reserve Duty and then relate this information to individuals who maybe applying for credit and may have protections under the Payday Law as dependents.

Access to accounts as security: Unless the definition of consumer credit is limited to certain small, short term loans, military personnel and their spouses and dependents may no longer have available to them loan products that offer a lower interest rate or other favorable terms to borrowers who agree to pay their loans automatically from their checking account (“direct debit”). They may also be less likely to open a savings account when they obtain a loan.

Section 987(e)(5) of the Payday Law makes it “unlawful” for a lender to use “a check or other method of access to a deposit, savings or other financial account maintained by the borrower, or the title of a vehicle as security for the obligation.” In effect, this means that military personnel and their spouses and dependents will no longer have available to them loan products that offer a lower interest rate or other favorable terms to borrowers who agree to pay their loans automatically from their checking account (“direct debit”). It also inhibits depository institutions from encouraging military personnel and their spouses and dependents to open savings accounts and make regular contributions at the time a loan is obtained, as those savings accounts are often used as security for the loan. Military banks, particularly, have been encouraged to and do offer such arrangements.⁶

Presumably, this provision was intended 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, the direct debit system and arrangements abused by payday lenders are the same system and arrangements used by depository institutions to provide millions of their customers the convenience of arranging automatic loan repayments.

⁶ A number of panelists at a forum sponsored by the FDIC and Association of Military Banks of America on *Affordable, Responsible Loans for the Military* held 6 December 2006 pointed out that incorporating a saving component with these products offered significant advantages for servicemembers, in particular, helping them build assets. Another distinct advantage and reason for the success of these programs is the ability of the lender to ensure loan payments through direct debit, often resulting in lower interest costs to the borrower. It is unlikely these programs could continue if a broad definition of consumer credit is adopted.

The advantages to consumers of direct debit are obvious: consumers can guarantee that they pay on time, wherever they happen to be, ensuring that they avoid late payment fees, adverse credit reports, and lower credit scores. With direct debit, they avoid the risks and consequences of paying late because a check was lost or delayed in the mail or the borrower simply forgot to make a payment. Direct debit is especially useful for borrowers such as servicemembers when they are away from home as they can be sure that they will not incur late payments and adverse credit reports.

Many lenders will offer a reduced interest rate or other favorable term to borrowers agreeing to make loan payments by direct debit. This includes, for example, mortgage refinancings and student loans. The lower interest rates and other favorable terms are feasible because the loan is less risky from the lender's perspective and administrative costs may be lower.⁷ If the Payday Law is applied broadly, though, these advantages will be unavailable to military personnel and their spouses and dependents.

The Payday Law will also prohibit lenders from using savings accounts as security for a loan. Yet, depository institutions, particularly those located on and near military bases and working with the Department of Defense, have developed programs that are intended not only to assist servicemembers with their short term credit needs but also to develop a savings habit so that they have a cushion in the event of unexpected expenses and thus avoid the need to resort to payday lenders.

Under this arrangement, borrowers may commit to programs to set aside in a designated savings account a portion of their pay or a fixed amount from each loan payment. The funds in the savings account in turn are pledged as security for the loan, as permitted by law, so that in the event that the borrower defaults on the loan, funds from the savings account may be used to offset the remaining loan balance. Some depository institutions may offer programs to combine a borrower's savings with matching funds from a nonprofit organization or public agency. Withdrawals from the savings account may be restricted to require authorization by a lending official of the institution. This approach encourages borrowers to create savings that lessen their reliance on short-term financing to meet unexpected needs. In addition, use of these programs offers an opportunity to educate servicemembers on the importance of saving. However, if the Payday Law is applied so that the savings account cannot be used as a security, the depository institution has less incentive to promote savings accounts with its loan programs, as doing so may increase the risk that the loan will not be repaid. To encourage depository institutions to continue

⁷ The Official Staff Commentary to Regulation E, which implements the Electronic Fund Transfer Act, specifically permits lenders to offer a program with a reduced interest rate or other cost-related feature as an incentive for borrowers to agree to automatic payments. (Comment 1 to 12 CFR 205(10)(e).)

offering such programs, we strongly encourage the Secretary to apply the statute narrowly.

Oral and written disclosures: Oral disclosures are not practicable for many popular loan products such as credit cards, which are increasingly offered by mail, Internet, and telephone rather than in person. Military personnel and their spouses and dependents may no longer have these products available to them if the regulation is not narrowly applied.

Section 987(e)(1) of the Payday Law requires that all disclosures (both those required under the Payday Law and those already required under the Truth in Lending Act) must be given **both** orally and in writing. The first challenge of this provision is providing the Truth in Lending Act (“TILA”) disclosures orally. TILA has never required that TILA disclosures be provided orally and was never designed with such a requirement in mind. The requirement to provide oral disclosures will entail a lengthy recitation that will be difficult to provide since TILA disclosures are currently intermingled with other contract terms or otherwise not in a form designed to be read aloud to the borrower.

This requirement under the Payday Law to provide disclosures orally, in effect, seems to mandate face-to-face contact between covered borrowers and lenders. While payday loans have typically involved in-person, face-to-face contact, many of the other products offered by regulated depository institutions that may be inadvertently covered by the new law if the term consumer credit is interpreted broadly are often not provided in-person. Arguably, most are *not* face-to-face transactions. Credit cards are one example of a product that is most often made available by mail, Internet, or telephone, rather than face-to-face. While these alternate channels present advantages for consumers, none of them create a practical, useful opportunity to provide oral disclosures. Mail delivery obviously presents little opportunity for an oral communication. Internet delivery of oral disclosures is also not practical. Delivery of disclosures over the telephone has other problems, since it is not always possible to ensure proper identification of customers nor feasible to expect the consumer to willingly stay on the telephone for a lengthy recitation of terms that will be provided more effectively to the borrower in writing, as required under Regulation Z.

The compliance problems for depository institutions attempting to make oral disclosures to consumers, even in face-to-face transactions, are hard to overstate. In order to do this successfully, every lender must maintain elaborate procedures, training processes, and expensive auditing programs to ensure and verify that each transaction is accompanied by the appropriate disclosures. Even with the strictest procedures, errors will occur. In contrast, written disclosures can be prepared in advance, using automated programs, meaning they can be carefully monitored and are consistent and complete. Lenders are also concerned that, in retrospect, with the prospect of voiding the loan and avoiding any repayment, borrowers (especially those seeking to escape repayment

obligations) will claim that some of the disclosures were not made correctly. The lender is then in the position of having to prove that they were. Since this statute has no tolerance for error and any error can result in voiding the transaction – and potential imprisonment – depository institutions will approach these loans with caution.

In short, wherever face-to-face delivery of disclosures is to be required, those types of transactions will be difficult —if not impossible—to consummate. This unintended consequence of the statute will be a particular burden for servicemembers who require flexible opportunities to access products and services. The use of new technologies permits servicemembers who are often on the move or in remote locations to access credit readily. If lenders avoid making some of their products available to servicemembers based on concerns about the difficulty of complying with the new oral disclosure requirement and the significant liability for failure to comply, servicemembers and their spouses and dependents will lose access to these financial services.

A narrow application of the Pay Day Bill will still address payday loans, which are still commonly provided in person, but minimize the burdens for loans not typically made in person. This means that servicemembers and their spouses and dependents will have continued access to the beneficial credit products they need and are not cut off from the variety of convenient delivery channels that make credit more accessible.

Prohibition against refinancing with the same lender: Unless the regulation is applied narrowly, military personnel and their spouses and dependents will not be able to take advantage of lower rates or better terms that are frequently offered when refinancing with an existing lender. In addition, they will not be able to participate in work-out loans with their existing lenders.

The Payday Law prohibits a lender from refinancing a loan with military personnel and their spouses and dependents -- even if the refinancing is a good option or otherwise beneficial to the borrower. More specifically, section 987(e)(1) of the new statute provides that “it shall be unlawful for any lender to extend consumer credit to a covered member or a dependent of such a member with respect to which the lender rolls over, renews, repays, refinances, or consolidates any consumer credit extended to the borrower by the same credit with the proceeds of other credit extended to the same covered member or a dependent.” While apparently aimed at payday loans, this provision of the Payday Law also applies to many other products that benefit military personnel and their spouses and dependents.

Unless the Secretary applies the Payday Law narrowly, this restriction will, among other things, prohibit lenders from refinancing the loans of military personnel and their spouses and dependents. Military personnel and their

spouses and dependents will not be able to take advantage of work-out loans or refinanced loans with lower rates or better terms offered by their current lender.

There are many appropriate and beneficial reasons for borrowers to refinance loans with the same lender. For example, in an environment of falling interest rates or rising real estate market values when consumers are eager to refinance their mortgage, servicemembers and their spouses and dependents may benefit from reduced or waived closing costs or lower rates when they refinance with their current lender. Lenders have strong incentives to offer existing customers pricing incentives to retain customers, as acquiring new customers is expensive. In addition, existing customers might not have to pay for the cost of another appraisal or other costs associated with mortgage loans, particularly with regard to costs associated with initially establishing a customer relationship with a depository institution. It is not clear whether “residential mortgages,” which are not covered under the Payday Law, include mortgage refinancings (as opposed to loans used to actually purchase a residence), but certainly military personnel and their spouses and dependents can benefit by refinancing a mortgage with the same lender. Moreover, we are not aware that payday loans are secured by borrowers’ residences.

Similarly, student loans are frequently refinanced with the same lender in order to reduce the interest rate or obtain additional funds. Or, upon graduation, borrowers may wish to consolidate several loans with the same lender in order to simplify finances by reducing multiple payments to a single payment. These refinancings would be prohibited if covered under the Payday Law regulation.

In addition to losing potential cost reductions, military personnel and their spouses and dependents having difficulty managing a loan would be prohibited from making arrangements with their existing lender to adjust the terms and conditions as part of a work-out loan. Work-out loans may involve reduced rates, smaller payments, or extended payment terms. Regulated depository institutions often work with borrowers who have encountered difficulties to make these types of work-out arrangements to avoid writing off the loan and to maintain the customer relationship. However, a broad application of the Payday Law would make this difficult, if not impossible.

Given the severe penalties associated with violating the Payday Law, we do not believe that a regulation should merely attempt to carve out loans which are “beneficial” to the borrower or have “lower costs,” for example. Any such standard is simply too subjective and the lender too easily in the position of being second-guessed. Is refinancing to pay for a child’s education “beneficial” to the servicemember? Is refinancing to pay for a parent’s medical expenses a benefit? If the loan imposes closing costs, but lowers the interest rate, is it offering “lower costs”? Potential imprisonment, fines, and voidance of the loan, which may mean forfeiture of the entire principal as well as interest and fees, simply present too great a risk in making loans based on any subjective standard. Regulated

depository institutions will err on the side of avoiding any such loans covered by the provision.

To ensure that military personnel and their spouses and dependents continue to have the same choices and advantages in refinancing loans as civilians do, we strongly recommend a narrow application of the Payday Law. This would include, in addition to defining “consumer credit” narrowly, making clear that the “residential mortgage” exception includes mortgage refinancings, home equity loans, and any other forms of credit secured by real estate.

New definition of APR: *If applied broadly, the “all-in” APR envisioned in the statute will distort the TILA APR and confuse and mislead consumers trying to compare and understand credit costs.*

Since first passed in 1968, the Truth in Lending Act (“TILA,” 15 USC 1601, et seq.) and its implementing regulation, Regulation Z (12 CFR Part 226), have governed the form and substance of *all consumer credit disclosures* in the United States. This universal coverage of TILA is in keeping with the stated Congressional purpose “. . . [T]o assure a meaningful disclosure of credit terms so that the consumer will be able to *compare* more readily the various credit terms available to him and avoid the uninformed use of credit . . .” (Emphasis added.) (15 USC 1601.) Perhaps the most important single disclosure, which is the core of TILA, is the annual percentage rate, commonly known as the APR. The APR was developed to provide a single, uniform method of calculating the cost of credit, to prevent customer confusion, and to enhance the ability of consumers to shop for the best terms. Accordingly, Regulation Z preempts inconsistent state laws that might call for different calculation methods for precisely this reason (12 CFR Section 226.28 (a) (1)).

The calculation of the APR is mandated by TILA and Regulation Z. The fact that the APR must be calculated in a uniform manner has been a staple of TILA as it has been interpreted and applied for over 30 years. An entire generation of consumers has grown up understanding that there is a uniform, single APR disclosed.

However, under the Payday Law, credit shopping will become greatly complicated if a new, different APR is added. This second APR will add confusion rather than offer useful information with which to judge other rates. Indeed, ultimately, this confusion may cause them to disregard APRs generally, undercutting Congress’ efforts to provide a meaningful term with which to compare credit costs.

The Payday Law’s definition of APR, if applied broadly, could compromise this decades-long effort to provide a workable means for consumers to compare credit costs by 1) presenting an *additional, non-comparable* APR which will confuse consumers and 2) in some cases, distorting the APR to the point that it

is misleading or becomes meaningless and overlooked by consumers. Below are some points for the Secretary to consider when addressing this provision:

- The existing APR definition in TILA includes fees and charges that are imposed directly or indirectly by the lender as an incident to or a condition of the credit. Not all fees are included in the current APRs, as Congress and the Federal Reserve Board recognize that including some fees, depending on the type of fee and type of loan, distorts the APR and undermines the goal of providing a uniform rate that consumers can use to compare and understand credit costs. Fees excluded from the APR are disclosed elsewhere.
- In open end credit, such as credit card plans and home equity lines of credit, lenders are required to disclose “other charges” that may be imposed as part of the plan but are not included in the APR. These charges include charges such as fees for late payment and exceeding the credit limit. Often these fees are imposed because the consumer has failed to meet the requirements of the open end credit plan. Including these fees and charges, even modest ones, in the APR, may distort the APR, artificially inflating it, especially when the balance is relatively small.
- Further, because the fees are imposed based on the borrower’s future behavior, the application of these fees or charges usually cannot be determined at the time the consumer enters into the open end credit plan; it is impossible for a lender to know in advance which customers will take an action triggering a fee and which will not.
- Fees and charges that are not in the current APR under TILA and are not classified by Regulation Z as “other charges” and disclosed separately have an even more tenuous relationship to the price of credit (and thus the APR) than “other charges.” These include, for example, fees to expedite delivery of a replacement credit card or certain other charges in loans secured by real estate. Such fees and charges are often optional and reflect additional services valuable to consumers that are not a condition of the credit and therefore do not affect the actual cost of the credit. Again, adding them to the APR calculation will often distort the APR by artificially inflating it. Moreover, many of these fees cannot be known in advance, as they are determined by the borrower’s behavior and choices.
- Fees and charges vary widely by the type of loan, making comparison of loan products difficult. Indeed, if the APR is artificially inflated, as discussed above, consumers may be led to believe that an alternative credit product is better when in fact it is not. For example, if a credit card plan imposes a 12% interest rate, but in a particular month the borrower incurs a late payment fee or fee for expedited delivery of a replacement card, the APR could be substantially higher for that month if the fee is included in the calculation. Consumers may be misled into believing that

an alternative credit card offering an 18% interest rate, for example, is a better choice, when in fact it is not.

Limiting the application of the regulation will minimize negative impact on the integrity of the existing APR and its usefulness to military personnel and their spouses and dependents.

In addition to the confusion that disclosure of two, non-comparable APRs will cause military personnel and their spouses and dependents, the requirement will require the creation of complicated and costly systems, forms, and compliance programs in order to provide a new set of consumer credit disclosures. It is unlikely that lenders will be able to create new compliance programs, reprogram automated systems, retrain personnel, and perform the necessary testing in time to meet the deadline anticipated in the Payday Law. The penalty for violation of these requirements is draconian: the nullification of the loan contract. If a violation, no matter how insignificant, is found to be “knowing,” a term of art subject to judicial review, the serious risk of criminal penalties, including imprisonment, is also presented. For these reasons, any compliance program must be fully tested and have a solid legal basis. Given the complexity and expense created by such a stark departure from standards for disclosure used over the last several decades (as described above), it is likely that many financial products subject to these new requirements will be unavailable to military personnel and their spouses and dependents for the foreseeable future.

This appears to have been an unintended consequence of a law that was designed to deal with payday loans rather than the array of beneficial consumer products offered by nonpayday lenders. Payday loans are often structured without many extra charges which might be of the type excluded from the APR under Regulation Z, but included in the new APR. Limiting the scope of coverage will minimize the problems identified.

Rate caps: An artificially inflated APR based on the Payday Law’s “all-in” APR would mean that military personnel may not have certain popular products available to them.

Section 987(b) of the Payday Law specifically prohibits lenders from imposing an APR of interest greater than 36 % on loans made to military personnel and their spouses and dependents. As discussed above, in cases where the fees normally not included in the TILA APR are now included in this new Payday Law APR, this new APR can easily exceed 36%, even when the fee is modest, if the loan balance is relatively small. The result will be that military personnel and their spouses and dependents may find that certain products, including credit cards, are unavailable to them.

- While a 36% APR that is charged based on the loan principal over the life of the loan is a comparatively high rate of interest, almost all credit cards

provide for fees for some transactions, such as a cash advance fee, that temporarily inflate the APR for a single statement period, and, when the balance on the account is low, may push the effective APR over the 36% cap.

- If additional fees are included in the APR calculation, the likelihood that an effective APR will exceed 36% will increase significantly. Rather than develop an additional credit card plan without fees (but that instead relies on a higher rate of interest) some lenders may find that they are unable to offer military personnel and their spouses and dependents their only viable credit card products.
- Similarly, while the Secretary could cap or prohibit fees for loans to servicemembers, the effect would be the same: rather than develop credit card products based on the capped fees or no fees, lenders may find that they are unable to offer military personnel and their spouses and dependents their only viable credit card products.
- Closed end loans such as installment loans may also include fees for optional services such as identity theft protection or credit report monitoring. If these and other fees are included in the expanded APR, closed end credit products may also be limited by the rate cap or a fee cap, making these products unavailable to servicemembers and their spouses and dependents, even though the fees or charges are for optional services valuable to customers.

Prohibition Against Change in Interest Rate: Prohibiting changes in interest rates after an account is opened will harm military personnel and their spouses and dependents. Their interest rates cannot be lowered (nor arguably their fees lowered) once the account has been opened. In addition, such a prohibition may raise their credit costs overall or limit their access to credit.

The Payday Law prohibits a lender who extends “consumer credit” from requiring the consumer to pay “interest” with respect to the credit “except as agreed to under the terms of the credit agreement or promissory note.” This language is not precise and leaves significant room for consumer harm, especially as it relates to credit offered in connection with a credit card.

On its face, the language would appear to prohibit the ability of a credit card issuer, for example, to change the terms of a credit card account agreement if such a change would alter the “interest” paid by the consumer. We assume, for purposes of this discussion, that this prohibition relates to changing the nominal interest rate applied to the account. Even with such a narrow definition of “interest,” it is relatively easy to demonstrate the obvious consumer harms if lenders are not permitted to alter the interest rate from the original contract. For example, a lender could not reduce the consumer’s interest rate to assist the consumer in connection with credit counseling or a debt management plan. Nor could a lender reduce the rate of borrowers who have demonstrated responsible

management of their credit. A lender also could not reduce the interest rate through a change in terms in an effort to retain a customer and dissuade the customer from switching to a different credit card. Moreover, since the Payday Law defines interest to include all costs and fees associated with consumer credit, it would make it difficult for a lender to waive or reduce fees, including fees for paying late or exceeding the limit, or even annual fees, since that would possibly be interpreted as “altering” the rate of interest, as well as make any disclosures inaccurate in violation of the restrictions.

This prohibition would also affect a credit card issuer’s ability to increase the interest rate, which may seem at first beneficial to the borrower. It is important to note, however, that such a prohibition would eliminate the flexibility lenders have to protect themselves against interest rate shocks due to interest rate market changes or other future events which may necessitate a change in terms. The net result of the prohibition would be lenders “pricing in” such risk as part of the *initial* interest rate charged. In other words, the lack of flexibility to change an initial rate increases lending risk, which will mean that the initial rate will be higher than if the lender had such flexibility. In the alternative, lenders could simply have credit cards expire in much shorter terms and decline to renew them if the cost of funds makes them unprofitable, or more simply, just terminate them and require borrowers to reapply to obtain a replacement card. We question whether these potential alternatives are a net benefit to military personnel and their spouses and dependents.

The concerns we raise, however, are not normal characteristics of payday loans. It is unlikely that a payday lender would lower an interest rate, nor would a payday lender need the flexibility associated with longer term credit agreements, since the term of a payday loan is usually measured in days or weeks. Therefore, we believe the Secretary could mitigate these issues and achieve the law’s primary objective by limiting the scope of “consumer credit” to payday lending, that is certain small, short term loans that are also covered under TILA’s Regulation Z.

Impact of Payday Law on affordable small-dollar loans. Even if the Payday Law is limited to small short-term loans, military personnel and their spouses and dependents could have limited access to affordable small-dollar loans offered by some depository institutions. Absent an exemption for depository institutions, depository institutions would be very challenged to continue offering such programs.

Some depository institutions have developed small denomination, short-term loan programs that are designed to meet the credit needs of members of the military and their families. These programs are intended to be a fair and affordable alternative to loans made by payday lenders. They usually include, for example, a financial education component. In contrast to abusive payday loans, which must usually be repaid in full on a specific date, the small-dollar loan

programs provided by insured depository institutions are payable by installments over time and the payment amounts are based on the budget of an individual borrower.

Direct debit of loan payments is a central, critical feature of many affordable small dollar loan programs. The direct debit provides a convenient payment mechanism for borrowers that makes paying on time easier, helping them manage their credit and build a good credit history, while reducing repayment risk – and thus costs – to the lender.

In addition to direct debit, affordable small dollar loan programs also often include a savings component. Encouraging a savings program promotes wise and prudent financial habits for the borrower and equips the borrower with a cushion against unexpected expenses, hopefully avoiding the need to rely on desperation sources for funding, such as payday lenders. To reduce the risk of loss to the insured depository institution, the savings account is often used as security for the loan, making the loan more affordable.

However, these critical features of affordable small-dollar loans, such as the direct debit and use of a savings account as a security, could very well be prohibited under the Payday Law. That is to say, if the application of the regulation is limited to certain small short-term loans without qualification or allowances, the affordable alternatives to payday loans could become unavailable to military personnel and their spouses and dependents even though federal banking regulators have issued strict advisories and guidelines that require regulated depository institution to be responsible when offering short-term loans.⁸ Absent an exemption for depository institutions, depository institutions would be very challenged to continue offering such programs.

Definition of “consumer credit” and “creditor”: In addition to narrowly defining consumer credit to certain small, short term loans, the Secretary should rely on TILA’s Regulation Z’s definitions of key terms such as “consumer credit” and “creditor” to avoid ambiguity and unintended consequences and to ensure clarity. The Secretary should also exempt certain types of loans such as loans against tax-deferred accounts.

In addition to limiting application of the Payday Law to small, short-term loans, the Secretary should rely on TILA’s Regulation Z in defining key terms

⁸ The FDIC requires institutions it regulates to: establish waiting periods between the time a payday loan is repaid and another application is made; establish the maximum number of loans per customer within a designated period; provide that no more than one payday loan is outstanding with the bank at a time to any one borrower; and ensure that payday loans are not provided to customers who had payday loans outstanding at any lender for a total of three months during the previous 12 months. The FDIC also has the authority to conduct examinations of third party service providers FDIC FIL-14 2005 (March 1, 2005). The Office of the Comptroller of the Currency has issued similar guidelines. See OCC AL 2000-10 (November 23, 2000).

such as “consumer credit” and “creditor.” TILA and Regulation Z have a long history of refining such terms to cover appropriate types of credit. For example, under section 226.2.(a)(12) of Regulation Z, consumer credit means “credit offered or extended to a consumer primarily for personal, family, or household purposes.” In addition, specifically excluded from Regulation Z coverage under section 226.3(a) is business, commercial, agricultural, and organizational credit. Regulation Z also exempts from coverage informal “credit” by service providers such as dentists, doctors, plumbers, etc., who provide occasional “credit” as a customer convenience.⁹ We believe that the intent of the Payday Law was to limit coverage to the types of loans subject to TILA and Regulation Z, that is, consumer credit. Referencing well-established terms will avoid ambiguity and promote clarity. In addition, consistent terminology facilitates compliance by eliminating confusion and conflicts among different definitions for the same term. Accordingly, the Secretary should reference the definitions of “consumer credit” and “creditor” contained in Regulation Z in defining these terms.

We also suggest that in addition to referencing the TILA’s Regulation Z definitions, the Secretary consider specifically exempting certain types of loans. These include, for example, loans from tax-deferred accounts such as 401(k) plans, insurance plans, and Federal Employee Retirement System plans. These loans may be small, short-term loans, but have not been the subject of abuses seen in payday lending. Such loans are covered under Regulation Z but should not be covered by the Payday Law. Otherwise, military personnel and their spouses and dependents could be limited in their ability to borrow against their own accounts, a valuable and beneficial option.

Prohibition against waiving rights: The provision making it illegal to extend credit where the borrower is required to waive rights creates a potentially impossible task of having to comply with the laws of all 50 states and the District of Columbia for every covered loan. Military personnel and their spouses and dependents may lose access to products as a result.

Section 987(e)(2) of the Payday Law makes it unlawful for a lender to extend credit to a person covered by this new law where “the borrower is required to waive the borrower’s right to legal recourse under any otherwise applicable provision of State or Federal law.” Presumably, this provision is intended to prohibit explicit waiver of legal remedies otherwise available in the absence of such waiver, such as jury trial waivers, class action waivers, and mandatory arbitration. However, the 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

⁹ See definition of “creditor” 12 C.F.R. 226.2(a)(17).

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.

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 *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.

Because the Payday Law can be enforced by private right of action where the penalty for a violation is 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 borrower's counsel. Limiting the coverage of the Payday Law to small, short-term loans would limit the extent of this problem and thus not foreclose the availability of other types of loans to military personnel and their spouses and dependents.

Compliance with state law: Because lenders may only know the address of record of the servicemember or their spouse or dependent, they will be unable to comply with the requirement to apply the laws of the state where a covered member is currently residing. This makes compliance a particularly daunting task, given the frequency of military transfers. Thus, military personnel and their spouses and dependents may have less access to credit if the Payday Law is not narrowly applied.

Section 987(d)(2) of the Payday Law prohibits states from “permit[ting] violation or waiver of any State consumer lending protections for the benefit of residents of the State on the basis of nonresident or military status of a covered member or dependent of such a member, regardless of the member’s or dependent’s domicile or permanent home of record.” At the outset, we note that this provision mandating states to act, as drafted, may not survive constitutional scrutiny. Furthermore, it is not clear what the penalty would be for a state’s failure to comply.

Aside from these fundamental issues, we believe that the Secretary should interpret “consumer lending protections” as those applicable to the payday lending industry and similar arrangements. We make this suggestion based on the practical difficulties this provision presents. Many times, lenders will know only the address of record for a consumer. This could be a home address, a work address, or other address at which the consumer wishes to receive mail. It will not necessarily be an address in the same state in which a servicemember, spouse, or dependent is currently stationed. Yet the lender would not necessarily know the state in which the covered member is residing, especially if the servicemember is relocated after the account is opened but does not change his or her billing address. Therefore, the lender would not know that a different state law applies, much less which state law applies. Not only does this create practical problems for lenders, it will force depository institutions that have chosen to operate in only one or two jurisdictions to be familiar with the laws of all 50 states and the District of Columbia in order to provide lending services to military families – an imposing burden for banks of any size.

Challenges for compliance: The cost and complexities of complying with the Payday Law will be staggering if it is not narrowly applied.

If the Payday Law is not narrowly applied, depository institutions face enormous, costly, and time-consuming changes to software programs, procedures, and applications as well as intensive staff training. It is not simply a question of downloading off-the-shelf software to make new calculations and disclosures and eliminating features such as direct debit. Applications must be reviewed, revised, reprinted, and redistributed. Staff must be trained to understand policies and procedures for identifying and responding to military personnel and their spouses and dependents. Lawyers and technical staff, vendors, and others must review software calculations, loan features, and disclosure systems and determine whether it is feasible to adjust existing systems or necessary to install new systems in order to comply with the Payday Law requirements. And those changes, particularly those related to technical systems changes, disrupt sensitive information and systems technology schedules, often carefully planned years in advance. Limiting application of the Payday Law will minimize the compliance impact.

V. Conclusion

The depository institution trade associations appreciate the opportunity to submit our thoughts on the implementation of the Payday Law. We hope to work closely with the Secretary to avoid unintended consequences that will deprive military personnel and their spouses and dependents of convenient, beneficial, and common certain credit products and terms. We believe that narrowly applying the regulation will effectively target payday loans and lenders, while ensuring military personnel and their spouses and dependents access to legitimate, beneficial credit products.

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American Bankers Association on behalf of the more than two million men and women who work in the nation's banks, brings together all categories of banking institutions to best represent the interests of this rapidly changing industry. Its membership--which includes community, regional and money center banks and holding companies, as well as savings associations, trust companies and savings banks--makes ABA the largest banking trade association in the country.

America's Community Bankers is the national trade association committed to shaping the future of banking by being the innovative industry leader strengthening the competitive position of community banks. To learn more about ACB, visit www.AmericasCommunityBankers.com.

Founded in 1959, the **Association of Military Banks of America** (AMBA) 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 recognized voice on retail banking issues in the nation's capital. Member institutions are the leaders in consumer financial services, including auto finance, home equity lending, card products, education loans, small business services, community development, investments and deposits. CBA was founded in 1919 and provides leadership, education, research and federal representation on retail banking issues such as privacy, fair lending, and consumer protection legislation / regulation. CBA members include most of the nation's largest bank holding companies as well as regional and super community banks that collectively hold two-thirds of the industry's total assets.

The **Independent Community Bankers of America** represents the largest constituency of community banks of all sizes and charter types in the nation, and is dedicated exclusively to representing the interests of the community banking industry. ICBA aggregates the power of its members to provide a voice for community banking interests in Washington, resources to enhance community bank education and marketability, and profitability options to help community banks compete in an ever-changing marketplace.

With nearly 5,000 members, representing more than 18,000 locations nationwide and employing over 265,000 Americans, ICBA members hold more than \$876 billion in assets \$692 billion in deposits, and more than \$589 billion in loans to consumers, small businesses and the agricultural community. For more information, visit ICBA's website at www.icba.org.