

BEFORE THE DEPARTMENT OF DEFENSE

**In the Matter of
Request for Comment on Proposed Regulation Implementing Limitations on
Terms of Consumer Credit Extended to Service Members and Dependents**

Docket No. DOD-2006-OS-0216

**Comments of the Staff of the Bureau of Consumer Protection, Office of Policy
Planning, and the Bureau of Economics of the Federal Trade Commission**

June 11, 2007*

*** These comments represent the views of the staff of the Bureau of Consumer Protection, Office of Policy Planning, and the Bureau of Economics of the Federal Trade Commission. They are not necessarily the views of the Commission or any individual Commissioner. The Commission has, however, voted to authorize the staff to submit these comments.**

I. Introduction

The Department of Defense (“DoD”) has requested comment on proposed amendments to its regulations to implement the military lending consumer protections of the John Warner National Defense Authorization Act of Fiscal Year 2007, section 670, “Limitations on Terms of Consumer Credit Extended to Service Members and Dependents” (“Act”).¹ Drawing on its experience with consumer protection and competition issues related to consumer financial services, the staffs of the Federal Trade Commission’s (“FTC’s”) Bureau of Consumer Protection, Office of Policy Planning, and Bureau of Economics (“FTC staff”) offer the following views to assist DoD in its rulemaking. In particular, the FTC staff supports the DoD’s proposal to: (1) focus the regulation on those products that it has found most problematic for Service members -- payday loans, title loans, and refund anticipation loans (“RALs”); and (2) apply the regulation to all types of lenders of these products, rather than exempting banks and similar entities.

The Federal Trade Commission is the only federal agency with both consumer protection and competition jurisdiction in broad sectors of the economy. That jurisdiction arises under the FTC’s enabling legislation, the Federal Trade Commission Act (“FTC Act”),² and more than 50 additional statutes. Under the FTC Act, “[u]nfair methods of competition in or affecting commerce, and unfair or deceptive acts or practices in or affecting commerce,” are prohibited,³ and the FTC has a general statutory mandate “to prevent persons, partnerships, or corporations” from engaging in such prohibited methods, acts, and practices.⁴ The competition and consumer protection missions of the FTC reinforce each other, as both serve the ultimate aim of maximizing consumer welfare: competition law protects consumers’ access to the fruits of vigorous competition by combating efforts to thwart free and open markets; and consumer protection law supports consumers’ effective participation in competitive markets by addressing unfair or deceptive conduct as it may arise in particular markets or transactions.

The FTC has wide-ranging responsibilities regarding consumer financial issues for most non-bank segments of the economy, including finance companies, mortgage companies, vehicle

¹ Pub. L. 109-364, codified at 10 U.S.C. § 987. The proposed amendments are found at 72 Fed. Reg. 18,157-18,170 (Apr. 11, 2007) (to be codified at 32 C.F.R. Part 232).

² 15 U.S.C. § 41 *et seq.*

³ 15 U.S.C. § 45(a)(1). In 1994, Congress clarified that an unfair act or practice over which the FTC has authority is one that “causes or is likely to cause substantial injury to consumers which is not reasonably avoidable by consumers themselves and not outweighed by countervailing benefits to consumers or to competition.” 15 U.S.C. § 45(n), added by The FTC Act Amendments of 1994, Pub. L. No. 103-312.

⁴ 15 U.S.C. § 45(a)(2).

and other retailers, and marketers of financial products.⁵ In addition to the FTC Act, the FTC enforces numerous financial services laws, including, among others, the Truth in Lending Act (“TILA”), the Fair Credit Reporting Act (“FCRA”), the Equal Credit Opportunity Act (“ECOA”), the Fair Debt Collection Practices Act (“FDCPA”), the Consumer Leasing Act (“CLA”), and the Electronic Fund Transfer Act (“EFTA”).⁶

The FTC’s role in fulfilling its core mission of protecting consumers extends beyond law enforcement activities to also include consumer and business education, competition and consumer protection advocacy,⁷ and public policy research. For example, the FTC’s website provides access to diverse consumer and business education materials about financial services, including credit cards and consumer loans, mortgage lending, credit reports, debt collection, identity theft, and information privacy, with some of these materials focused specifically on protecting military personnel.⁸ In addition, the FTC and its staff have recently filed briefs and comments with courts⁹ and regulatory agencies, respectively, setting forth views on consumer financial issues.¹⁰ The FTC staff further has conducted extensive research to inform public policy decisions related to financial services, such as recent economic research evaluating the efficacy of mortgage disclosures.¹¹ Most recently, FTC staff participated in the interagency

⁵ Banks, savings and loan institutions, and federal credit unions are exempt from the general grant of jurisdiction under the FTC Act. 15 U.S.C. § 45(a)(2).

⁶ The TILA is at 15 U.S.C. §§ 1601-1667f. The FCRA is at 15 U.S.C. §§ 1681-1681(u). The ECOA is at 15 U.S.C. §§ 1691-1691f. The FDCPA is at 15 U.S.C. §§ 1692-1692o. The CLA is at 15 U.S.C. §§ 1667-1667f. The EFTA is at 15 U.S.C. §§ 1693-1693r.

⁷ FTC advocacy filings are available at http://www.ftc.gov/opp/advocacy_date.shtml.

⁸ Available at <http://www.ftc.gov/bcp/online/edcams/credit/index.html>. See, e.g., “‘Active Duty’ Alerts Help Protect Military Personnel from Identity Theft,” available at <http://www.ftc.gov/bcp/online/pubs/alerts/dutyalrt.pdf>. See also “Competition Counts: How Consumers Win When Businesses Compete,” available at <http://www.ftc.gov/bc/edu/pubs/consumer/general/zgen01.pdf>.

⁹ See, e.g., Brief of the Federal Trade Commission as Amicus Curiae Supporting Appellants, Whitfield v. Radian Guaranty, Inc., No. 05-5017 (3d Cir. Mar. 2006).

¹⁰ See, e.g., FTC Comments Before the Board of Governors of the Federal Reserve System (Sept. 14, 2006) (home equity lending market), available at <http://www.ftc.gov/os/2006/09/docketop-1253commentfedreservehomeeqlenditextv.pdf>; FTC Comments Before the Board of Governors of the Federal Reserve System (Feb. 4, 2005) (proposed amendments to Regulation E on electronic fund transfers), available at <http://www.ftc.gov/be/v050001text.pdf>; and Comments of the FTC Bureau of Economics, Bureau of Consumer Protection, and Office of Policy Planning Before the Department of Housing and Urban Development (Oct. 28, 2002) (proposed amendments to regulation implementing the Real Estate Settlement Procedures Act), available at <http://www.ftc.gov/be/v030001.pdf>.

¹¹ See Notice of Agency Information Collection Activities, 70 Fed. Reg. 820 (Jan. 5, 2005). See also Federal Trade Commission Bureau of Economics Staff Report, The Effect of Mortgage Broker Compensation Disclosures on Consumers and Competition: A Controlled Experiment, James M. Lacko and Janis K. Pappalardo (Feb. 2004),

working group that consulted with DoD regarding this proposed regulation.¹²

II. The Act and the Proposed Regulation

The Act and proposed regulation essentially impose limits on “creditors” who offer “consumer credit” to Service members and their dependents. Among other things, the Act and proposed regulation require oral and written disclosures,¹³ a 36% rate cap,¹⁴ and numerous other lending limitations. These include prohibitions or restrictions on the following: (1) refinances and renewals by the same creditor; (2) borrower waivers of legal recourse; (3) mandatory arbitration; (4) creditor demands for certain notices from borrowers; (5) creditor use of checks or other access to borrowers’ deposit or financial accounts; (6) creditor use of vehicle titles as security; and (7) prepayment penalties and fees.¹⁵ Creditors who violate the Act or regulation are subject to criminal penalties; contracts that violate the Act or regulation are void.¹⁶ The Act and proposed regulation take effect on October 1, 2007.¹⁷

The Act directs DoD to develop implementing regulations, including defining the terms “creditor” and “consumer credit.”¹⁸ As discussed below, DoD’s proposed regulation defines “consumer credit” to cover payday loans, title loans, and RALs to military consumers.¹⁹ The proposed regulation also defines “creditor” to include those who are in the business of extending such consumer credit to military consumers.²⁰

III. Scope of Proposed Regulation: Coverage of Products

Congress passed the Act in response to DoD’s submission of its report on predatory

available at <http://www.ftc.gov/os/2004/01/030123mortgagefullrep.pdf>.

¹² See 10 U.S.C. § 987(h)(3).

¹³ See 10 U.S.C. § 987(c); proposed 32 C.F.R. § 232.6.

¹⁴ See 10 U.S.C. § 987(b); proposed 32 C.F.R. § 232.4(b).

¹⁵ See 10 U.S.C. § 987(e); proposed 32 C.F.R. § 232.8.

¹⁶ See 10 U.S.C. § 987(f); proposed 32 C.F.R. § 232.9.

¹⁷ Pub. L. 109-364, Div. A, Title VI, Subtitle F, § 670(c), 120 Stat. 2269; proposed 32 C.F.R. § 232.11.

¹⁸ See 10 U.S.C. § 987(h).

¹⁹ See proposed 32 C.F.R. § 232.3(b).

²⁰ See proposed 32 C.F.R. § 232.3(e).

lending affecting the military (“DoD Report”).²¹ DoD’s Report noted:

Military families have characteristics that can make them a market of choice for predatory lenders. Forty-eight percent of enlisted Service members are less than 25 years old, typically without a lot of experience in managing finances, and without a cushion of savings to help them through emergencies. They are on their own without the guidance or assistance of family, with perhaps their first significant paycheck. They are paid regularly and are not likely to be downsized, outsourced or to quit their employment. Also, the military culture emphasizes financial responsibility, with basic policy explicitly stating that Service members are to pay their just debts.²²

The DoD Report focused on particular products, including payday loans, title loans, and RALs, that contribute to a “cycle of debt” or proliferation of extremely high costs and other problems.²³ Although the Act’s protections apply to “consumer credit,” the term is not specifically defined in the statute: instead, it will have the “meaning provided . . . in regulations prescribed under this section . . .”²⁴ The Act also specifically directs DoD to prescribe regulations to carry out the law, including defining the term “consumer credit.”²⁵

DoD has proposed, as an initial matter, to define “consumer credit” to cover three problematic credit products addressed by the DoD Report (payday loans, title loans, and RALs).²⁶ In developing this definition, DoD also considered, among other things, government, consumer group, and academic reports and studies; media reports; and state laws.

In addition to focusing on products that cause the most harm, DoD recognized that extending its regulation to cover additional credit products could have the unintended, adverse consequence of severely disrupting the availability of credit to military consumers. As DoD explained,

²¹ Department of Defense, Report on Predatory Lending Directed at Members of the Armed Forces and Their Dependents (Aug. 9, 2006). *See also* 72 Fed. Reg. at 18,159.

²² DoD Report at 10 (footnote omitted).

²³ *See generally* DoD Report. *See also* 72 Fed. Reg. at 18,159-18,160.

²⁴ 10 U.S.C. § 987(i)(6). The Act does, however, exempt residential mortgages and vehicle and other personal property purchase money transactions that are secured by the item purchased. *Id.* DoD included these exemptions in its proposed definition of “consumer credit.” *See* proposed 32 C.F.R. § 232.3(b)(2)(i)-(iii).

²⁵ *See* 10 U.S.C. §§ 987(h)(1) and (2)(D).

²⁶ Proposed 32 C.F.R. § 232.3(b).

The Department's proposed definition of the term "consumer credit" is intended to narrow the regulation's impact to consumer credit products and services that are potentially detrimental and for which there are DoD-recommended, alternative products or services available to Service members and their families. DoD believes that a narrow definition can prevent unintended consequences while affording the protections granted by the statute.²⁷

DoD explained that by streamlining the definition, many products (e.g., lower-cost small loans) that military consumers may need will still be available.²⁸ In addition, the definition adopted provides an incentive for the financial services industry to develop and offer military consumers alternatives to payday loans, title loans, and RALs.²⁹

The FTC staff believes that the scope of covered consumer credit products under DoD's proposed regulation is reasonable. DoD considered Congressional intent, the problematic characteristics of these particular products in the military context, and the need for military consumers to retain the ability to obtain credit from other sources, such as for medical, dental, and other bills. Indeed, if DoD extended the Act's substantial restrictions to additional credit products, it could cause lenders to decrease or discontinue the extent to which these products are offered to military consumers, resulting in a widespread loss of access to credit, including for emergencies. In short, DoD's approach – confining the reach of the regulation to those areas where Congress and DoD saw the greatest problems – addresses both the need for consumer protection and the need for military consumer access to vibrant lending markets.

Moreover, DoD's initial focus on the three problematic products is reasonable, because DoD retains the authority to issue further regulations in the future covering additional credit products, if they are demonstrated to be commonly associated with similar problems. It affords DoD the opportunity to observe the impact of the regulation on the availability of covered products, which may provide guidance on issues related to the likely effect if these restrictions are applied to additional products. Consequently, DoD has the ability to expand, and the framework for assessing the impact of expanding, the coverage of products in its regulation, if that proves necessary to protect military consumers from injury.

²⁷ See 72 Fed. Reg. at 18,162-18,163.

²⁸ See 72 Fed. Reg. at 18,163.

²⁹ *Id.*

IV. Scope of Proposed Regulation: Coverage of Entities

A. Proposed Coverage

The Act's requirements apply to anyone who is a "creditor," a person who "is engaged in the business of extending consumer credit" and "meets such additional criteria as are specified for such purpose in regulations prescribed under this section"³⁰ The Act expressly directs DoD to prescribe regulations implementing the definition of "creditor."³¹ DoD's proposed regulation defines a "creditor" as a "person who is engaged in the business of extending consumer credit with respect to a consumer credit transaction covered by this part."³² The Act and the proposed regulation therefore cover all types of entities that extend payday loans, title loans, and RALs to military consumers; it provides no exemptions based on the type of lender.³³

FTC staff believes that the proposed definition of "creditor" in DoD's proposed regulation reflects a sound policy decision. As discussed above, the Act and proposed regulation reflect a Congressional determination that the covered products and practices harm military consumers. Exempting entities by category would restrict the protections accorded to these Service members and their dependents. In contrast, under DoD's approach, regardless of which entity may solicit Service members or dependents, or that Service members or dependents may contact (by Internet, telephone, mail, or in person) for covered credit products, these military consumers will be protected.³⁴ No entity will be given a free pass to noncompliance, nor will covered entities be placed at a competitive disadvantage relative to exempt entities.

³⁰ 10 U.S.C. § 987(i)(5). DoD implemented certain other aspects of the Act's definition of "creditor" that affect "assignees" elsewhere in the proposed regulation.

³¹ See 10 U.S.C. §§ 987(h)(1) and (2)(D).

³² Proposed 32 C.F.R. § 232.3(e). This provision also defines the term "person," and states that the person must otherwise meet the definition of "creditor" under Regulation Z, 12 C.F.R. Part 226.

³³ Indeed, DoD expressly noted that it did not propose excluding any types of lenders from the regulatory definition of "creditor." See 72 Fed. Reg. at 18,162.

³⁴ Thus, Service members and dependents need not first ascertain whether the particular entity is subject to the law to determine with whom they can reasonably conduct business. Indeed, it can be challenging for consumers to ascertain this information. Storefront or Internet entities that may be the first point of contact with the consumer, such as marketers or advertisers via the Internet, are not necessarily the actual "creditor," or credit extender, for the transaction. In the FTC staff's experience, other entities including finance companies and banks have frequently served as the true "creditor," i.e., the company listed on the credit agreement as "creditor" and with whom the consumer signs the credit agreement. This information can be buried in obscure areas of websites or in fine print in contractual documents.

B. Exemption for Banks

DoD has specifically requested comment on the question of “whether the final regulation should exclude regulated banks, credit unions and savings associations and their subsidiaries from coverage by the regulation generally, or in various limited circumstances”³⁵ The FTC staff believes that the proposed regulation appropriately applies its restrictions in an even-handed way across lending entities, while covering demonstrably problematic lending practices.³⁶ Therefore, the FTC staff are concerned that exempting banks, credit unions, or savings associations – and their subsidiaries – from the final regulation may have unintended, detrimental consequences for Service members and their dependents.

In the past, banks – along with finance companies and others – have offered and extended to consumers credit products that would be covered by DoD’s rule, such as RALs and payday loans. For example, according to the DoD’s recent report to Congress, which DoD cited in accompanying materials with the proposed regulation:³⁷

Refund anticipation loans (RALs) are very expensive short-term loans secured by the taxpayer’s expected tax refund. Consumers took out approximately 12.38 million RALs during the 2004 tax-filing season and paid \$1.24 billion in RAL fees and \$360 million in associated fees to tax preparers and *banks* that make these loans.³⁸

DoD also cites to a study by Gregory Elliehausen of the Credit Research Center which notes various lenders with large RAL programs – all of them banks.³⁹ Banks – along with finance companies and others – also have offered payday loans to consumers, although more recently

³⁵ 72 Fed. Reg. at 18,162.

³⁶ The FTC staff also notes that the Act provides a very broad definition of “creditor,” and makes no reference to a carve-out for banks or similar entities (let alone their subsidiaries). See 10 U.S.C. § 987(i)(5).

³⁷ See 72 Fed. Reg. at 18,159.

³⁸ DoD Report at 20 (emphasis added).

³⁹ See Credit Research Center, “Consumer Use of Tax Refund Anticipation Loans” (Apr. 2005), at 1 (citing numerous banks with substantial RAL programs). See also 72 Fed. Reg. at 18,160. “RALs are made by banks, which allow them to charge interest rates that would otherwise exceed state usury caps.” Nat’l. Consumer Law Center and Consumer Federation of America, “Picking Taxpayers’ Pockets, Draining Tax Relief Dollars: Refund Anticipation Loans Still Slicing into Low-Income Americans’ Hard-Earned Tax Refunds,” Jan. 2005, at 9. In 2006, banks continued to extend RALs for their tax preparer partners. See Nat’l. Consumer Law Center and Consumer Federation of America, “One Step Forward, One Step Back” (Jan. 2007), at 12-15.

federal bank regulators have discouraged the practice.⁴⁰ Accordingly, banks and other entities have offered some of the specified credit products that the proposed regulation would restrict.

Banks and other entities are subject to regulatory oversight and various regulatory requirements.⁴¹ Nevertheless, only the Act and proposed regulation establish, as a matter of law, the specific lending requirements and protections that they address for military consumers. Moreover, the Act does not grant bank regulators or other regulators aside from DoD the authority to issue and enforce regulations concerning its requirements, including those that are tailored to military consumers.

Thus, the contemplated exemption would leave banks and other entities free to extend payday loans, title loans, and RALs to military consumers without limitation, while imposing considerable restrictions on competing lenders who offer the same types of credit to these consumers. As a result, the exemption could have an unanticipated and undesired effect – reduced competition among lenders with regard to the specific types of loans addressed in the proposed rule and serious detrimental impacts upon consumers. Such reduced competition could result in less desirable terms for Service members or their dependents, including but not limited to higher interest rates or fees. That risk may be especially great in certain local markets for payday loans or RALs.⁴²

In sum, in the absence of market studies or other evidence that military consumers benefit when banks and similar entities engage in the practices that Congress generally found harmful, FTC staff believes that treating these entities the same as other entities under the proposed

⁴⁰ See, e.g., Center for Responsible Lending, “Financial Quicksand: Payday Lending Sinks Borrowers in Debt with \$4.2 Billion in Predatory Fees Every Year” (Nov. 30, 2006); and FDIC Release 107-2006, “Affordable Small-Dollar Loan Guidelines” (Dec. 4, 2006), available at <http://www.fdic.gov/news/news/press/2006/pr06107a.html>.

Banks in the past have been involved in payday lending, partnering with other entities that have availed themselves of less restrictive laws in banks’ home states. See, e.g., Graves and Peterson, “Predatory Lending and the Military: The Law and Geography of “Payday” Loans in Military Towns,” *Ohio State Law Journal*, Vol. 66, No. 4 (2005).

⁴¹ Such banking regulation may occur at the Federal and/or state level, depending on the entity and practice. Additionally, finance companies and other non-bank entities can be subject to licensing and other requirements at the state level, in addition to various Federal requirements. The nature and extent of the state requirements can, of course, vary by state.

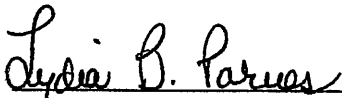
⁴² Indeed, if only some entities that may offer such products are excluded from the Act’s protections, military consumers may be singled out for unequal treatment and subjected to the same harmful practices legitimized by exemption. If certain entities are subject to the law – which contains a total pricing restriction of 36% and substantial other consumer protections – and others can engage in such practices at will, some entities may find they cannot continue in that market. This could leave Service members with credit offers primarily, or exclusively, by exempt entities. Such an approach can capture Service members and dependents in a market plagued by the very practices that the law sought to eliminate.

regulation is a reasonable approach.

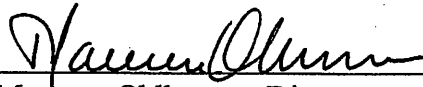
V. Conclusion

The FTC staff supports DoD's proposed regulation because it is narrowly tailored to prevent practices that Congress concluded were causing harm to military consumers and because it preserves the ability of military consumers to seek and obtain other forms of credit. We appreciate your consideration of these views.

Respectfully submitted,



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