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Federal Docket Management Systems Office
4800 Mark Center Drive
Second Floor, East Tower
Suite 02G09
Alexandria, VA 22350-3100

RE: RIN 0790-AJ10, Limitations on Terms of Consumer Credit Extended to Service Members and Dependents

Dear Sir or Madam:

On behalf of the National Association of Federal Credit Unions (NAFCU), the only trade association that exclusively represents federal credit unions, I am writing to you regarding the recent Department of Defense (Department or DoD) proposed rule on Limitations on Terms of Consumer Credit Extended to Service Members and Dependents. NAFCU has significant concerns about the potential unintended consequences to credit unions based on the proposed changes in the rule.

First and foremost, NAFCU strongly supports our servicemembers and their families and appreciates the opportunity to comment on this proposed rule. NAFCU believes in consumer financial protections for our nation's servicemembers, and credit unions have a proven track record of protecting the interests of their members. However, NAFCU is dedicated to ensuring that there are no unintended consequences with the changes proposed to the definition of consumer credit which would prevent credit unions from providing essential credit products to members who serve in the military and their dependents. This proposed rule, if finalized, could impact credit unions' ability to provide credit products to servicemembers due to the interest rate restrictions already imposed on credit unions. The additional cost of compliance would also severely impact small and mid-sized credit unions and provide another barrier to offering small dollar loans generally.

NAFCU believes strongly that it was not the overall intent of Congress to curtail the practices of abusive payday lenders at the expense of frustrating the ability of legitimate and fair lenders to provide financial products and services that are in the best interest of America's military families.

While NAFCU certainly supports the overall intent of protecting servicemembers, we are concerned that many of the changes in this proposed rule may create significant compliance costs

for credit unions, which in turn will negatively impact the military personnel and dependents who are member-owners of credit unions. Because credit unions are member-owned not-for-profit cooperatives, any adverse economic impact on a credit union is ultimately felt by its members. Thus, unnecessary regulatory burdens also create indirect harms for military families, by raising the cost of services that credit unions provide. For example, increased operational costs could lead to lower share savings rates, as well as the reduced availability of reasonably priced financial products and services for military members and their dependents. In some circumstances, implementation costs may be so cost-prohibitive as to deter some financial institutions from offering certain products and services altogether.

Credit Unions Differences

Credit unions are different than most other types of financial institutions. Credit unions, as member-owned-and-operated financial depository institutions, have long been—and will continue to be—leaders in the push against unscrupulous lending practices, particularly those that exploit military personnel. The credit union industry is dedicated to helping its member-owners avoid predatory lenders by providing them with small, low-cost loans and offering financial education to assist them in developing sound debt management skills. Due to their efforts in this area, credit unions are recognized leaders in the fight to eradicate predatory lending.

Credit unions are also different because credit unions have a statutory interest rate ceiling already in place. The Federal Credit Union Act (FCUA) imposes a statutory limit on the interest rate that credit unions may charge at 15 percent. The National Credit Union Administration Board (NCUA Board) has limited discretionary authority to increase the 15 percent rate only under certain circumstances. Currently, the NCUA Board has set the annual percentage rate (APR) cap at 18 percent, inclusive of all finance charges. *12 C.F.R. § 701.21(c)(7).* NAFCU is concerned that, if the rule is finalized as proposed, the changes will prove problematic given the National Credit Union Administration's (NCUA) reliance on the definition of the finance charge in Regulation Z and the treatment of finance charges under proposed rule. Specifically, if this rule is finalized, it will impact the credit union's military APR (MAPR) calculations for credit products to servicemembers, and will likely result in credit unions being unable to offer existing valuable products to their military members and their dependents.

Payday Alternative Loans (PAL)

Credit unions have one product that will likely be directly affected by the proposed rule and which is heavily regulated by NCUA. NCUA regulations contain provisions for a *Payday Alternative Loan (PAL)* which is a small dollar loan that is highly regulated including specific regulatory restrictions, guidance, and best practices. *See 12 C.F.R. § 701.21(c)(7)(iii).* This product is specifically designed to be an alternative to predatory payday loans. This product and, only this product, have an exception to the general statutory interest rate cap, and compliant PALs are subject to an interest rate cap of 28%. A PAL is a closed-end loan that must have a principle of between $200 and $1,000 with a maturity term between one month and six months. Federal credit unions are also prohibited from making more than three PALs in any rolling six

month period and more than one at a time to a specific borrower. They may not be rolled-over unless a credit union does not charge additional fees or extend new credit. The application fee to all members applying for a PAL must reflect actual costs associated with processing the application and may not exceed $20.

It is important to understand NCUA's rationale for allowing the application fee with this product. The application fee for PALs are designed to cover the actual costs associated with processing the application and to administer the loan itself. NCUA made a well thought out decision that the application fee for this product should not be included as a finance charge when calculating APR. This is a decision that NAFCU supports. This proposed rule would include the application fee for this product that would be considered a finance charge under the MAPR calculation.

Many of these types of loans are loss-leaders in credit unions and are offered strictly for the benefit of their members who are in need of short-term small-dollar alternatives to payday lenders. NAFCU believes that these types of short-term small-dollar loans are an integral part of the reason that credit unions are considered leaders in the push against predatory lending. Also, these types of loans give credit unions another opportunity to work with members to get them back into the traditional banking system and away from unregulated or under-regulated predatory actors. This proposed rule could provide a challenge for credit unions to provide small-dollar loans because of the change in definition of finance charge and how it relates to how the MAPR is calculated. The result will likely be less short-term small-dollar loan products available for service members from reputable lenders like credit unions.

Definition of Consumer Credit

Under the proposed rule, the Department would expand the scope of the definition of "consumer credit" from the three specific types of credit products currently covered by the regulation to cover a much broader range of closed-end and open-end credit products, to be generally consistent with the requirements of the Consumer Financial Protection Bureau's (CFPB) Regulation Z.

NAFCU believes that the current regulation was appropriately tailored and strongly supports the current regulation's narrow focus on payday loans, vehicle title loans, and tax refund anticipation loans. The proposed rule's expansion of the definition of "consumer credit" to the much broader range of credit products will produce significant unintended consequences and significant regulatory burdens for credit unions and ultimately for their member-owners including servicemembers and their dependents.

NAFCU's believes that any loans that comply with the FCUA and NCUA's implementing regulations should be outside the scope of the regulation's definition of "consumer credit." That includes NCUA regulated PALs. Lending activities by federal credit unions are already very highly regulated; indeed, credit unions are subject to greater regulatory restrictions and more stringent lending limitations than other financial depository institutions. *See e.g. 12 C.F.R. 701.21.* As such, NAFCU suggests that should the definition of consumer credit be expanded in any final rule, the Department permit a credit union, upon application to the NCUA, to exclude

from coverage consumer credit that is consistent with the FCU Act. This approach would encourage credit unions to offer more affordable, small-dollar, short-term loans to American military families while still affording the protections granted by the statute.

Identifying Covered Borrowers

The proposed rule requires creditors to determine whether a consumer is a covered borrower when credit is offered or extended. *79 Fed. Reg. 58602, 58639 (to be codified at 32 C.F.R. 232.5).* Currently, a lender may rely on applicants' statements that they are not covered under the regulation, but this proposed rule attempts to "relieve a Service member…or dependent from making any statement regarding his or her status as a covered borrower…" *79 Fed. Reg. 58602, 58614.* In doing so, the burden is placed on the lender to verify each and every borrower to make sure they are or are not a servicemember or dependent. The proposal offers creditors a safe harbor from this requirement if they check the DoD's Military Lending Act Database (Database) and retain a record of the information obtained. The safe harbor does not extend to creditors that have *Actual Knowledge* that the person is covered. This provides a number of issues for credit unions such as the reliability of the Database and added compliance costs for credit unions to adjust their internal systems to retain a record of checking the DoD Database and for keeping actual knowledge from non-consumer loan transactions.

Safe Harbor

NAFCU generally agrees with providing a safe harbor for identification of covered borrowers. However, we are concerned that the mechanism for the safe harbor may not be appropriate in light of the significant logistical and reliability issues with the Database as well as the significant potential penalties that can be assessed.

NAFCU strongly supports the availability of a safe harbor for identifying and monitoring covered borrowers, but not as currently proposed. NAFCU believes that any final rule should not adopt an approach to place the burden for identification of covered borrowers on the creditor. Rather, any final rule should be modeled after the Servicemembers Civil Relief Act (SCRA) which requires service members to notify financial institutions of their eligibility for SCRA protections. *See 50 U.S.C. App. § 501, et seq.*

NAFCU is also concerned that the proposed safe harbor fails to protect creditors from being criminally penalized for inadvertent violations of the law. The risk of noncompliance carries the heavy threat of significant penalties, so the safe harbor must provide creditors with a dependable method to assure compliance; otherwise, legitimate and fair lenders will be frustrated from providing financial products and services that are in the best interest of America's military families due to concerns over penalties.

The Database

The proposed rule presents many practical issues, especially the reliability of the Department's Database on which credit unions will have to rely for compliance in order to use the safe harbor.

The Database is frequently unavailable and often times the Department does not provide any advance notice for things such as updating and maintenance. This raises serious questions about whether credit unions can rely on the Database in a timely fashion and if not, what should be done by a credit union during times when the Database is down. Would the safe harbor apply if the credit union kept a screenshot of the Database being down at that time? The practical impact is that when the Database is unavailable, credit unions will not be able to open credit accounts or close consumer loans for any consumer until the Database is again available.

The current problems with reliability are likely to be intensified given the significant increase in the volume of inquiries the Department will have to manage if the proposal is adopted as proposed. This assumption is based on the fact that virtually every consumer loan across the country will need to be checked against the Database in order to utilize the safe harbor.

The compliance processes that will need to be put in place at credit unions will be time-consuming and costly based on the current iteration of the Database. Some of these problems rely on how credit unions will have to retain a record of the information obtained from the Database. Currently, some credit unions take screen shots and images to satisfy the requirements of the Servicemembers Civil Relief Act (SCRA). Others use batched requests which the SCRA database allows for. The rule as proposed would require credit unions to determine whether an applicant is a dependent of a servicemember, and therefore a covered borrower. However, the Database does not provide information relating to dependents. The MLA Database should provide information relating to dependents, but does not currently allow for batch processing. In order to make the Database a more useful tool for lenders, NAFCU urges the Department to include the ability to batch data so that those lenders are not required to check the Database individually for each inquiry.

NAFCU believes that this is just one of a number of compliance related questions with the current iteration of the Database and that this rule as proposed will add significant costs that will affect all credit unions.

Actual Knowledge

The proposed rule requires creditors with "actual knowledge" that a consumer is a covered borrower to treat that consumer as a covered borrower notwithstanding any determination by that creditor based on information obtained from the DoD Database. "Actual knowledge" my be established on the basis of a record collected by the creditor prior to entering into a transaction and maintained in any system used by the creditor that relates to the consumer credit involving that consumer.

This presents a significant operational challenge for credit unions specifically. Credit unions, unlike other types of financial institutions, often have long standing relationships with their member-owners. Those relationships, sometimes spanning decades, have multiple points of contact with their members including phone calls, branch visits, online or through websites, and mobile applications. Through any of those multiple points of contact during any of those long standing relationships, credit unions would be responsible for both capturing any indication their

member is a covered borrower and then ensuring that the captured data indicating that the person is a covered borrower is then applied to anyone applying for future consumer credit. The data could be stored as a call note, change of address, or use of a military ID during a branch visit. This rule would require credit unions to make significant changes to their internal systems as well as changes to their staff training. Due to the substantial penalties for non-compliance, the proposed rule puts credit unions and their employees at serious risk.

NAFCU believes that the Department should require servicemembers and their dependents to self-identify as it does with The Servicemembers Civil Relief Act (SCRA). *See 50 U.S.C. App. § 501, et seq.* NAFCU recommends that a similar notification requirement should be instituted in any final rule. This solution would remove the onerous compliance and operational challenges that the proposed rule offers credit unions and would free credit unions and their staff to better focus on products and services that will ultimately better benefit servicemembers and their dependents.

Mandatory Disclosures

The proposed rule would require that creditors must provide to covered borrowers the following before or at the time the borrower becomes obligated on the transaction or establishes an account for credit: 1) Statement of the MAPR; 2) Regulation Z disclosures; 3) A clear description of the payment obligation of the borrower as applicable; and 4) statement about financial protections and assistance for covered borrowers.

These disclosures must be provided in writing and orally with transactions that are done through mail, internet, and point of service transactions conducted with sale of non-financial products. Creditors may also provide a toll-free number on or with written disclosures when a borrower contacts the creditor in lieu of oral disclosures.

The proposal presents significant risks, challenges, costs for all depository institutions, but particularly for credit unions, given the compliance burden. Credit unions who offer consumer credit products, even if they believe that they comply with all of the requirements of the regulation, at the very least, must identify military personnel and dependents to provide the required oral disclosures. Credit unions must develop an internal database to capture and centralize any and all records of documents they have that might indicate a customer is a servicemember or spouse or dependent of a servicemember, and create a system so that relevant personnel have real-time access to that internal database as well as the Department's Database of active military personnel and their spouses and dependents. This comes at no small cost.

The disclosures required by the proposed rule will also slow down the ability of credit unions to provide consumer credit to all of their members and will require significant time and costs to implement. Credit unions will have to spend money and time on re-training many of their staff on the intricacies of this rule including identifying covered borrowers through the Database as well as the disclosure requirements. Additionally, credit unions will have to redesign and reprint disclosure documents and set up an 800 number and dedicate staff to man the call centers to provide disclosure information.

MAPR

Under the proposed rule, creditors would be required to provide a statement of Military Annual Percentage Rate (MAPR) in their disclosures. *See 79 Fed. Reg. 58602.* MAPR Compliance with the regulation is complicated: it is not simply a matter of limiting interest to 36%.

NAFCU believes that the Defense Act's definition of "annual percentage rate" should be read to be consistent with the meaning of this term under the Truth in Lending Act (TILA), *15 U.S.C. 1601, et seq.,* which is implemented by the CFPB's Regulation Z. *See 12 C.F.R. Part 1026.*

NAFCU believes that any dual disclosure requirements could lead confusion among military borrowers. Indeed, multiple disclosures will inhibit loan comparison, hinder the accurate promotion of credit products and unduly complicate advertisements, and might even lead to the mistaken perception that military consumers are being unfairly discriminated against.

The consumer disclosure provisions contained in the Defense Act and TILA share the same fundamental goal: to clearly inform borrowers of the true cost of credit. TILA and Regulation Z already provide ample disclosure protections for all consumers, including military borrowers. Requiring a "distinctive" MAPR that is inconsistent with the current TILA APR is not only counterproductive to the military consumer protection purposes of the Defense Act, but might actually negate the effectiveness of the current TILA APR disclosure.

Accordingly, for the purposes of the MAPR disclosure under this proposed rule, NAFCU recommends that the regulation mirror the calculation approach taken by Regulation Z.

Limiting Credit Options

Credit unions, most especially those serving the military, have taken the lead in creating predatory lending alternatives—low-dollar, short-term, credit products with low fees for the military. Many credit unions will only make these types of products available on the condition that the service member participates in financial education, which helps the member to develop sound debt management skills, and to improve his or her financial health and well-being. NAFCU is concerned that the limitations imposed by this proposed rule could impede the innovation of emerging products and services and deter credit unions from developing and offering loan products that may provide real benefits to military members and their families.

Effective date

According to the proposed rule, for prior extensions of credit between October 1, 2007 and the effective date of any final regulation, the requirements are the same as those which were required on October 1, 2007. For new extensions of credit, the requirements of any final rule will take effect after that effective date and will apply only to a consumer credit transaction or accounts for consumer credit consummated or established on or after the effective date of any final rule.

NAFCU believes that if finalized, the proposed rule will require significant changes for credit unions and other covered creditors. Credit unions will need adequate time to develop new disclosures and loan applications, establish toll-free telephone numbers for providing oral disclosures, create new loan policies, make changes to internal systems to provide for database integration, and conduct staff training. NAFCU urges the Department to give credit unions at least one full year from the date of publication in the *Federal Register* for any final regulation to effective to provide creditors sufficient time for implementation and to test system changes.

Suggested changes

If the Department finalizes the rule, NAFCU has a few recommendations that will help to protect military personnel and their spouses and dependents from specific, identified predatory loans such as payday loans, car title loans, military installment loans, rent-to-own programs, and tax refund anticipation loans which are products primarily offered by non-bank financial institutions. The results of these changes would steer servicemembers and their dependents towards highly regulated credit unions and their member first consumer credit products. First, NAFCU recommends that the Department exempt from the regulation all federally insured depository institutions. This would follow the intent of the legislation as well as provide servicemembers with greater protections from predatory lenders without adding the extraordinary compliance and regulatory burdens that accompany this proposed rule. An exemption would steer servicemembers and their dependents away from non-depository predatory lenders and into more mainstream consumer credit products.

If the DoD decides not to exempt all depository institutions, NAFCU would request that the DoD exempts credit unions from the proposed changes, including new coverage under an expanded definition of "consumer credit". In this case, credit unions would remain covered by the existing MLA rule. Another reason that credit unions should be exempt is due to the highly regulated and relatively limited nature of their operations. Each credit union is closely scrutinized and regularly examined by NCUA, and/or the credit union's State Supervisory Authority, and in some cases the Consumer Financial Protection Bureau (CFPB).

In the alternative, if the Department does not institute an exemption for either all federally insured depository institutions or credit unions, NAFCU believes that the Department should at the very least consider a carve-out for specific regulated products such as PALs. These are consumer and servicemember friendly products designed specifically to provide short-term small-dollar loans for a small portion of the cost of predatory payday lenders and without the hidden fees and tricks.

In addition, NAFCU urges the Department to require servicemembers and their dependents to self-identify. As a comparison, the Servicemembers Civil Relief Act (SCRA) requires service members to notify financial institutions of their eligibility for SCRA protections. *See 50 U.S.C. App. § 501, et seq.* NAFCU recommends that a similar notification requirement should be instituted in any final rule. This change would remove many of the concerns involving the Database and lessen the unintended consequences to all consumers while continuing to protect

servicemembers and their dependents. The costs of disclosure would continue to be burdensome, but many of internal system changes required by the proposed rule could be mitigated.

Conclusion

Given the serious operational and compliance burdens that would be instituted by this proposed rule if finalized, NAFCU strongly urges the Department to fully and carefully contemplate how this proposed regulation and the totality of regulatory burden on federal depository institutions ultimately impacts the financial quality of life for our military personnel.

NAFCU would like to thank you for the opportunity to share its views on this proposed rulemaking and we look forward to continuing to work with the Department of Defense on this and other important issues. If you have any questions or need additional information, please contact me at (703) 842-2215 or PJ Hoffman, NAFCU's Regulatory Affairs Counsel at (703) 842-2212.

Sincerely,

B. Dan Berger
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