COMMENTS

of the

National Consumer Law Center
Consumer Federation of America
Center for Responsible Lending
Consumers Union
National Association of Consumer Advocates

Regarding

Limitations on Terms of Consumer Credit Extended to Service Members and Dependents

Department of Defense,
FR Doc. 06-9518
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COMMENTS

The consumer groups identified above submit these comments in response to the Department of Defense's request for recommendations concerning regulations to implement the John Warner National Defense Authorization Act for Fiscal Year 2007, § 670, codified at 10 U.S.C. 987. (These comments refer to the law as the "Military Lending Act," or MLA.)

We have extensive experience with credit regulation. As have military groups, we have seen the wide variety of abusive credit products and practices that are on the market, and have detailed knowledge about how existing laws and regulations often fail to protect consumers, including military consumers.[1] We also have experience in the effect that regulatory changes have had on the availability of credit. (In fact, we have found that reforms can have a positive effect not just on borrowers but also on honest, efficient lenders and the marketplace itself.[2]) Because our mission is to further the interests of consumers generally, we have always strived to curb abusive and high cost credit products while promoting and protecting consumers' access to reasonably priced credit.

Our concerns are unequivocally aligned with the purpose of the MLA and the Department's efforts to combat predatory lending. We offer our recommendations in the spirit of offering a framework that we believe would implement the goals of the Act, while minimizing its impact on legitimate, low-cost credit.

SUMMARY OF KEY RECOMMENDATIONS

In devising our recommendations, we were guided by three basic principles which are key to effectively implementing Congressional intent: a) the primary goal is to protect our servicemen and women, and, in doing so, our national security; b) the key provision of the Act is a protection against high-cost lending, irrespective of what creditor issues it, or what form the credit takes, and c) MLA requires that the 36% cap be all-inclusive of fees and costs of credit.

We also understand that some clarification and streamlining is warranted, though it must be narrowly tailored to avoid undermining the Act's goals. To that end, we propose that creditors offering lower-cost products within a "safety-zone" triggered by the price of the credit be exempt from most, though not all, of the Act's substantive provisions. For open-end credit, the safety-zone would be, at the option of the creditor, a rate at 18% or

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[1] One of the earliest reports on the problem of predatory lending to the military was the National Consumer Law Center's "In Harm's Way at Home: Consumer Scams and the Direct Targeting of America's Military and Veterans" (May 2003), *available at* *http://www.consumerlaw.org/initiatives/military/index.shtml*.

[2] Experience has shown that there is a dysfunctional 'Gresham's Law," by which bad money (and its sources) can drive out "good money" providers. Effectively crafted regulation can correct those distortions. *See, e.g.* Wei Li and Keith S. Ernst, *The Best Value in the Subprime Market: State Predatory Lending Reforms,* (Center for Responsible Lending, February 23, 2006); www.responsiblelending.org .

below, with some specified allowances for fees, or 24% for no-fee accounts. For closed-end credit, the safety zone would be at or below 24%, with fees included. A price trigger is the only dividing line for reduced compliance requirements that is consistent with MLA.

We do not propose full exemption for lower cost credit for two reasons: first, we believe that some of the provisions are so important that any exemptions would be inconsistent with the Act, and second, we believe that most mainstream providers would face minimal, if any, significant compliance burden for those provisions.

We also offer a mechanism by which credit products ordinarily operating within the safety zone may retain the exemption even if the credit occasionally exceeds the limits. On those occasions, the covered member could ask for a refund of the excess, and the creditor could "cure' by providing the credit. Of course, there must be conspicuous notice to the service members of this right.

These recommendations make a specific suggestion for informing active duty military and their dependents about only one right under our proposal. However, informing active duty military and their dependents of MLA rights in general will be key to successful implementation of the Act. The Department, industry, and military and consumer groups all have critical roles to play in this education and awareness campaign.

I. PRINCIPLES AND RATIONALE UNDERLYING OUR RECOMMENDATIONS

The goal of the MLA is to safeguard military morale and readiness by reducing the incidence of financial problems attributable to high-cost lending, irrespective of its source. The text of the law, in its specifics, has been criticized. Some of the criticisms are philosophical, some operational; much of it is overstated or misguided. Separating the wheat from the chaff among these criticisms makes the task facing the Department more difficult. We hope that the industry will set aside philosophical objections in the interest of placing the well-being of our service men and women paramount, to minimize that burden on the Department.

We do recognize that some clarification and streamlining is warranted. This can and should be narrowly tailored, in order that it not violate the spirit of this law which has overwhelming support from Congress, the Executive Branch and our military leaders.

The Department has the critical and difficult task of devising a regulatory framework that first and foremost implements MLA's goals. Beyond that essential bottom line, it must balance concerns about legitimate operational difficulties with the need to avoid opening loopholes in the law. Our recommendations seek to strike that balance.

As we have previously expressed, we believe that the regulations should follow these three principles:

- The primary goal should be to protect military borrowers from abusive credit products, not to protect existing credit practices.

- The regulations, like the statute, should treat all lenders equally.

- The term "interest" should be interpreted inclusively so that the 36 percent cap is meaningful and opportunities for evasion are minimized.[3]

A. There should be no categorical exclusion for any class of creditors.

We are aware that some critics of the law have gone so far as to ask that some or all depository institution be exempt from the law entirely. Such proposals ignore the undisputed facts that some depository institutions, including both federally-chartered and other federally-insured financial institutions, were part of the problem leading to the passage of MLA, and continue today to be part of the problem. The DOD Report to Congress described predatory products offered by banks, including refund anticipation loans and overdraft loans. There are many other examples that illustrate the dangers of allowing predatory lending to continue simply because of the identity of the lender.

Bank Payday Loans*:* Federally-insured depository institutions offer products that do not differ in any meaningful respect from the standard "payday loan" product. They are priced like payday loans, and, just like those loans, they can trap borrowers in perpetual debt. For example:

- Wells Fargo Bank and U.S. Bank, both federally-chartered banks, offer a "direct deposit account advance" with high up-front fees ($1 per $10 borrowed), repayable on payday. The advertised APR is 120%, but that assumes that a loan is made the day after payday and is not repaid for 30 days.[4] More likely, an advance is made later in the pay cycle. The rate for a $500, 2-week advance is 260.7%; for a 1-week advance it is 521.4%.

  These account advance loans create a "debt treadmill" hazard just as traditional payday loans do. U.S. Bank permits consumers to take 18 consecutive advances before imposing a three-month cooling off period. Wells Fargo reduces the size

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[3] We elaborate on this principle in Section V-A-2, below.

[4] *See* US Bank Checking Account Advance, http://www.usbank.com/cgi_w/cfm/personal/products_and_services/checking/caa.cfm.; Wells Fargo Direct Deposit Advance Service Agreement and Product Guide, https://www.wellsfargo.com/downloads/pdf/checking/dda/termsandconditions_english.pdf.

of loans only after borrowers use them for twelve or more consecutive months.[5] These are not "low-cost alternatives" to payday loans; these are payday loans.[6]

- First Bank of Delaware, a state-chartered, federally-insured bank, offers installment loans through the internet provider PurposeLoans.com, aimed at the "frequent customer of cash advance." The loan shown on the website is a $300 loan paid in six biweekly payday installments for a total of $45.06 over three months – an APR of 350%.[7]

- First Bank of Delaware also partners with ACE Cash Express to make high cost loans in Arkansas, a state with a constitutional usury cap. A $1,000 loan repaid over twenty weeks in ten equal installments will cost $997, for a total of $1,997. An Arkansas borrower would pay 391% APR for this bank loan made through a check cashing outlet.[8]

Prices at payday levels, a treadmill comparable to payday levels, and the kind of partnerships with payday lenders that remind us of the long history of "rent-a-bank" payday lending to evade state usury caps,[9] all provide ample evidence that excluding banks from the protections of the MLA leaves open a gaping loophole for evading the law's promised 36% rate cap for military borrowers.

<u>Bank-Funded Holiday, Pay Stub and Refund Anticipation Loans</u>: Refund anticipation loans are one of types of predatory loans identified by the Department as a problem for Service members."[10] *All refund anticipation loans (RALs) are made by banks* through tax

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[5] Thomas Lee, "Banks Find Way to Bridge the Payday Gap," Star Tribune, January 21, 2007.

[6] The number of consecutive loans allowable under these programs is equal to or in excess of the 9 roll-over/renewals, which is the average for payday borrowers. *See, e.g.* Uriah King, Leslie Parrish & Ozlem Tanik, *Financial Quicksand*, p. 7, Center for Responsible Lending (November 30, 2006), *available at http://www.responsiblelending.org/pdfs/rr012-Financial_Quicksand-1106.pdf* As to their price, a recent newspaper article in Utah charted the comparative rates for these bank account advance loans, Utah payday and car title loans, and "1960s Mafia loans." The 1960 Mafia rates were the lowest among them. Lee Davidson, "Do banks overcharge?" Deseret Morning News, January 22, 2007.

[7] http://www.purposeloans.com, visited November 16, 2006. Cost compared to a $300 payday loan rolled over and repaid after six terms for a total repaid of $570 and a 390% APR.

[8] Email communication fro H.C. "Hank" Klein, Little Rock, Arkansas, July 6, 2006; Press Release, "ACE Cash Express Reports Fiscal 2006 Third Quarter Results," April 27, 2006 announced installment loans from First Bank of Delaware in Arkansas and Pennsylvania.

[9] For a history of some banks' cooperation with payday lenders to help them evade state usury laws, see, e.g.**,** Jean Ann Fox, CFA, "Unsafe and Unsound**:** Payday Lenders Hide Behind FDIC Bank Charters to Peddle Usury: A CFA Report on Devices Used by Payday Lenders to Evade State Usury and Small Loan Laws," March 30, 2004.

[10] See Department of Defense, Report on Predatory Lending Practices Directed at Members of the Armed Forces and Their Dependents at 20 (Aug. 9, 2006) (hereinafter, "DOD Report").

preparers, retailers and fringe financial service providers. The Defense Manpower Data Center Active Duty Survey in 2006 found that four percent of all Service members reported taking out a refund anticipation loan. Since many consumers confuse a tax refund loan with a "rapid refund," this self-reported information likely understates the number of Service members using RALs.[11] NCLC and CFA estimate from IRS data that 7.5% of Service members received refund anticipation loans in 2005. If so, Service members paid $10 million to borrow against their tax refunds from a handful of banks.[12] RALs cost 40% to 500% APR, depending on the size of the loan. With extra fees included in computing the interest rate as required by the Military Lending Act, RALs cost 57% to 1,100% APR.

Moreover, these loans are becoming even more of a problem as they are offered earlier and earlier in the season as "pay stub" loans or "holiday loans."[13] These alternatives are even more pernicious because they are based only on a rough estimate of the borrower's likely tax refund instead of an estimate prepared after preparing a tax return.

Refund anticipation loan facilitators cluster around military bases in a pattern similar to the distribution of payday lenders as reported by Peterson and Graves in their article on payday loans in military towns.[14] Mapping of RAL facilitators in North Carolina and Washington demonstrates that RAL lenders have more locations than population alone would justify around Ft. Lewis in Washington and around Ft. Bragg, Camp LeJeune, and Seymour Johnson Air Force base in North Carolina.[15]

The Military Lending Act 36% usury cap should apply to loans by banks that are facilitated by tax preparers.

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[11] For a full discussion of RALs, see NCLC and CFA, "Picking Taxpayers' Pockets, Draining Tax Relief Dollars: Refund Anticipation Loans Still Slicing Into Low-Income Americans' Hard-Earned Tax Refunds," January 2005. An NCLC poll found that 70% of RAL users did not realize they had received a loan, with younger consumers least likely to know a RAL was a loan. A CFA poll found that RAL borrowers are heavier users than non-RAL borrowers of other high cost fringe financial services, such as rent-to-own, payday loans, and pawnshop loans. See NCLC/CFA, "Another Year of Losses: High-Priced Refund Anticipation Loans Continue to Take a Chunk Out of Americas' Tax Refunds" at 10 (January 2006).

[12] Total calculated assuming average refund is $2,500, fees total $100. If additional fees charged by some RAL lenders are included, the total is higher. See: NCLC/CFA, "Down But Not Gone: Quick Tax Refund Loans Continue to Gouge Taxpayers," January 16, 2007, reporting on 2005 IRS data for tax year 2004.

[13] Chi Chi Wu, National Consumer Law Center, and Jean Ann Fox, Consumer Federation of America, "Pay Stub and Holiday RALs: Faster, Costlier, Riskier in the Race to the Bottom," November 2006.

[14] Steven M. Graves and Christopher L. Peterson, "Predatory Lending and the Military: The Law and Geography of 'Payday' Loans' in Military Towns," *Ohio State Law Journal* Vo. 66, No. 4, 2005.

[15] See maps prepared by Steve Graves, California State University at Northridge, in Appendix A.

***Bank ATM and Debit Card Bounce Loans**:* Just as is the case with RALs, the very expensive "bounce loans" are a bank product. This very expensive and damaging form of high-cost credit should not be excluded either through a general exemption for the banks who make them, or through a specific exemption for the product.[16]

Bank overdraft or "bounce" loans will continue to extract triple-digit interest from Service members if banks are exempted from complying with the Military Lending Act. For each check, ATM withdrawal, point of sale debit card purchase or preauthorized debit that overdraws the account, the bank imposes its $20 to $35 per incident overdraft fee. Consumers do not apply for or sign agreements to borrow through overdrafts and do not receive Truth in Lending cost disclosures.

Bounce loans operate just like payday loans by imposing large up-front fees that roll over and add up, plunging the borrower into a cycle of debt that is difficult to escape.[17]

Deceptively named "bounce protection," this loan – as the Department's predatory lending report pointed out[18] – can carry an 877% interest rate on ATM withdrawals or debit card purchases that banks encourage without informing customers that they are overdrawn or will incur a large fee.[19] The Department's Report to Congress highlighted the problems caused by overdraft loans for Service members who are required to have a bank account to receive direct deposit of their military pay.

As reported by a California credit union official, "courtesy pay" overdraft loans became a debt trap for young military personnel. The USA Federal Credit Union in San Diego quickly found that **nearly 33% of their overdraft loan users overdrew more than five times a month.** This led to a "downward spiral" and "fees add up quickly"; as "the negative balance grows, this causes a dependency on the product, similar to the 'rolling' of a payday loan." The average amount that triggered an overdraft was less than $100 and

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[16] In Section III-D-1-d, below, we discuss the consensus that overdraft loans are "credit" and why exempting them would be outside of the Department's regulatory authority.

[17] For example, a Social Security recipient's bank funded debit card purchases and an ATM withdrawl with bounce loans, added bounce fees to the point that repayment of these "loans" plus $99 in overdraft fees means that he has $238 taken to repay these loans off the top of his next month's $599 Social Security income. Eric Halperin, et al, *Debit Card* Danger at 10, Center for Responsible Lending, (January 25, 2007), *available at* http://www.responsiblelending.org/pdfs/Debit-Card-Danger-report.pdf.

[18] DOD Report at pp. 34-35.

[19] See Consumer Federation of America and National Consumer Law Center, "Bounce Protection:" How Banks Turn Rubber into Gold by Enticing Consumers to Write Bad Checks: An Examination of Bounce Protection Plans, " available at http;/www.consumerlaw.org/action_agenda/bounce_loans/appendix.shtml; Lisa James and Peter Smith, "Overdraft Loans: Survey Finds Growing Problems for Consumers," (Center for Responsible Lending Issue Paper No. 13, April 26, 2006) available at http://www.responsiblelending.org/pdfs/ip013-Overdraft_Survey-0406.pdf.

25 percent of users were under twenty-five years of age, largely from the soldiers and sailors in their field of membership.[20]

Young military personnel using plastic debit cards to access their bank accounts as they move around the globe are especially vulnerable to overdraft fees. Recent reports from the Center for Responsible Lending document that nearly three quarters of the $10.3 billion in overdraft fees paid each year come from chronic borrowers living on the margins of solvency. A CRL analysis of a large database of personal checking account transactions shows that debit card purchases at point-of-sale top paper checks, ATM withdrawals and online bill payments as the leading cause of overdrafts. Due to the difference in size of the overdrafts, **consumers pay $2.17 in fees for every dollar borrowed on debit cards**, compared to check overdrafts that cost 86 cents per dollar borrowed. When asked how they would like their banks to handle debit card overdrafts, *over sixty percent would prefer that the bank deny a debit card purchase that overdraws their account*, and nearly all would cancel their ATM withdrawal if warned they had insufficient funds.[21]

The DOD Report observed that most military banks and credit unions offer more reasonable traditional overdraft protection through a line of credit or credit card transfer at rates closer to 19%.[22] The rules to implement the Military Lending Act should protect Service members from overdraft loans which function as the bank equivalent of payday lending while encouraging banks to offer Service members lower cost protection.

There are other examples, but these highlight the pitfalls of excluding whole classes of providers, including depository institutions. Moreover, such a broad exclusion would be clearly contrary to Congressional intent. Congress made a clear decision to reject the banks' vociferous request for an exemption, and any such blanket exemption for a class of institutions would be inconsistent with and undermine the purpose of the law.

A further consideration is that banks, unlike payday lenders, are exempt from state laws other than their home state, and the big banks all choose a home state with no interest rate limitations. Federal law that protects Service members should not create a gaping hole that the states cannot fill.

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[20] Mary Cunningham, "Why Our Credit Union Has Wrestled With Realities of 'Courtesy Pay,'" *Credit Union Journal*, January 17, 2005 (Appendix _D).

[21] *See* "Debit Card Danger," *supra* note 17.

[22] A study by Sheila Bair, then a professor at the University of Massachusetts at Amherst and now the Chairman of the Federal Deposit Insurance Corporation (FDIC), found that banks had the ability to develop low cost alternatives to payday loans, but that "(b)anks and credit unions benefiting from overdraft fee income may not want to cannibalize this income by offering their customers lower-cost, small dollar credit options." Sheila Bair, "Low Cost Payday Loans: Opportunities and Obstacles" at 4 (June 2005), available at http://www.aecf.org/publications/data/payday_loans.pdf.

B. There should be no broad exclusion for specific product categories, such as "credit cards," "open-end credit", or exclusions based on the size of the loan

We strongly urge against defining the scope of MLA's coverage based on loan amounts or on specific product types. We understand that the Department is being urged to limit the scope of MLA's protections to small dollar loans. But Congress did not impose a dollar limit, and no reasonable person can argue that a 50% rate on a $10,000 loan is less financially devastating to a servicemember than a 100% rate on a $500 loan. Moreover, the problem with predatory small loans is that they turn into big loans as they are rolled over by the same or other creditors.

The head of the Navy-Marine Corps Relief Society testified before the Senate Banking Committee about a large installment loan that cost more than the recommended 36% rate cap. "At Cashcall, you can borrow $5,000, and if you make scheduled payments only (120 payments over ten years), you will end up paying back more than $30,000."[23]

Similarly, the scope of the Act should not be defined in terms of specific kinds of credit products. Product-specific exclusions create an easy loophole to evade the law just as do exclusions based on the identity of the credit provider. Indeed, the kinds of products some of the Act's critics have mentioned as warranting exclusion, such as "open-end credit" generically, or credit cards specifically, are products that can, and do, fall well within the targeted exploitive credit.

> * A payday lender offers an "open-end credit line" product in Pennsylvania at a nominal APR of 6%, but with a $149 monthly "participation fee." For a $500 loan, the effective rate is 364%.[24]
>
> * A major auto title lender casts its 264% or more title loans as "open-end credit" in three states to take advantage of an open-end rate loophole in those states' law.[25]

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[23] Admiral Steve Abbot, USN (Ret.), President & CEO, Navy-Marine Corps Relief Society, Senate Banking, Housing And Urban Affairs Committee, "A Review of the Department of Defense's Report on Predatory Lending Practices Directed at Members of the Armed Forces and Their Dependents" (Sept. 14, 2006) (hereinafter, "Senate Predatory Lending Hearing"). According to news reports, a $5000 loan to be repaid in seven years costs 59% interest. Other CashCall loans made in partnership with First Bank & Trust of Milbank, S.D. costs as much as 96% annual interest. Chuck Jaffe, "CashCall.com Offers Loan of a Lifetime… Literally," Boston Globe, Nov. 28, 2006.

[24] Pennsylvania Dept. of Banking v. NCAS of Delaware, LLC, d/b/a/ Advance America Cash Advance Centers, Sept. 27, 2006. This Advance America product exploits a loophole created by the Federal Reserve Board's exclusion of "participation fees" from the definition of "finance charge" for purposes of TILA disclosures. Compare 15 U.S.C. § 1605 (statute does not exclude such a fee) with Reg. Z, § 226.4(c)(4) (regulation excludes it). This exclusion enables Advance America to disclose this extremely high-cost line of credit as carrying an APR of 6%.

[25] Jean Ann Fox, "Driven Into Debt: CFA Car Title Loan Store and Online Survey, " Consumer Federation of America, November 2005, at 8-9.

* First National Bank offers a credit card product with an APR of 18.9% on a credit line of $250, but it also imposes a "processing fee" of $9, an "acceptance fee of $119, an annual membership fee of $50, and a $6 per month "participation" fee. This all adds up to a total of $184 in fees for simply opening up this $250-limit account. The first bill – before the consumer uses the account – has $175 owing.[26]

* The REVEL Advance is an open end line of credit up to $1,000 provided to holders of the REVEL prepaid debit card issued by state-chartered, FDIC supervised First Bank & Trust, Brookings, SD.[27] This payday loan on a debit card is marketed to young consumers through convenience stores, check cashers, and rent to own outlets. The card issuer claims not to charge interest, but piles on fees: the card itself costs $5.95 per month plus $4.95 to $9.95 per month if there is a balance and $3.95 each time the card is reloaded. In addition, a cash advance costs 8% to 10% of the amount borrowed. The card accepts direct deposit of paychecks and payment for the advance is automatically withdrawn from the card on the borrower's payday. The open-end card can be used over and over just like a check-based payday loan. The bank issuing this payday loan card is part of the Fishback Financial Corp. family of banks that have a long history of rent-a-bank payday lending.[28] In comments filed with the FDIC on proposed guidelines for responsible small lending, the President of First Bank & Trust noted that initial cash advances on its debit card cost more than the Military Lending Act's 36% rate cap.[29]

II. THE DEPARTMENT'S REGULATORY AUTHORITY

Before we detail our concerns and our recommendations, it is useful to review the scope of the regulatory authority given to the Department of Defense under the Act. The MLA

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[26] Perry v. First National Bank, 459 F.3d 816 (7th Cir. 2006). Cortrust Bank, N.A. (a national bank) offers an almost identical card. *See* Bonner v. Cortrust Bank, N.A., 2006 WL 1980183 (N.D. Ind. July 12, 2006).

[27] www.REVELCard.com. Terms and conditions for card lists a $25 overdraft fee per incident up to a total $125 overdraft including fees.

[28] Fishback Financial is the holding company for three banks that partnered with storefront payday lenders prior to enforcement action by the Comptroller of the Currency and supervisory pressure from the FDIC led to termination of those contracts. Banks include First National Bank of Brookings, Community State Bank, and First Bank of White, all based in South Dakota, a state with no usury cap. For more information on rent-a-bank payday lending, see, Jean Ann Fox, CFA, "Unsafe and Unsound**:** Payday Lenders Hide Behind FDIC Bank Charters to Peddle Usury: A CFA Report on Devices Used by Payday Lenders to Evade State Usury and Small Loan Laws," March 30, 2004.

[29] Comments filed by Van D. Fishback, President and CEO, First Bank & Trust, at FDIC re: Proposed Guidelines for Affordable Small Dollar Lending," January 16, 2007 at 5, posted at www.fdic.gov/regulations/laws/publiccomments/comments_small_dollar_loans.html, last visited Jan. 31, 2007.

gives the Department the authority to adopt regulations to carry out the Act, including the definition of certain key terms and "[s]uch other criteria or limitations as the Secretary of Defense determines appropriate, consistent with the provisions of this section."[30]

The requirement that the regulations be "consistent with the provisions" of the MLA, which is repeated in connection with several of the specific definitions,[31] is an important one. Though the Department's authority and discretion are fairly broad, they are not unlimited. Any regulations must be consistent with both the letter and spirit of the MLA.

In particular, the regulations must be consistent with the MLA's overall purpose and its core provisions. The MLA's overall purpose is to protect the financial health of Service members and to preserve military readiness by limiting high cost credit practices. The MLA's most central provision is the rule that credit extended to members of the military cannot exceed 36%. The Department has the authority to adopt limitations on and criteria for the enforcement of the MLA's provisions only if they are consistent with these goals. It does not have the authority to limit the operation of the MLA – as some have urged – in ways that undercut the purpose of the MLA by allowing high cost credit above 36% to members of the military.

The central purposes of the MLA are the animating force that underlies our concerns and recommendations for the operation of specific provisions.

III. ONLY LOWER-COST CREDIT SHOULD BE OFFERED SOME EXEMPTIONS FROM MLA REQUIREMENTS

A. Introduction

The only credit that deserves an exemption from the MLA is credit that does not pose a problem for military families and that was not Congress's concern: lower cost credit. Credit that is substantially below 36% can be rewarded with an exemption from most of the Act's other provisions. Our proposal would exempt lower cost credit from any need to identify military customers and from most restrictions on their products or operations. Drawing the line between lower cost and high cost credit, rather than between types of credit or creditors, ensures that abusive high cost credit products of the type identified in DOD's predatory lending report – internet payday loans, refund anticipation loans, and manipulative fee-based ATM and debit card overdraft loans – will be covered no matter who offers them.

[30] 10 U.S.C. § 987(h)(2)(E).

[31] *See* 10 U.S.C. § 987(h)(2)(B) ("The method for calculating the applicable annual percentage rate of interest on such obligations, in accordance with the limit established under this section"); *id* § 987(h)(2)(D) ("Definitions of `creditor' under paragraph (5) and `consumer credit' under paragraph (6) of subsection (i), consistent with the provisions of this section) (emphasis added).

We propose to exempt lower cost credit that falls within any of these safety zones from many of the Act's provisions:

- Open-end credit:[32]
  -- 18% APR or less, plus fees, or
  -- 24% APR or less, with no fees
- Closed-end credit: 24% or less, calculated including fees

There would be some tolerances for modest annual, application or late fees. For the 18% category, to ensure that the fees do not become a vehicle for avoiding MLA's 36% cap, the creditor would have the obligation, upon request of the servicemember, to make appropriate reductions to ensure that the fees and interest, beyond a limited late fee, do not exceed 3% per month.

We refer to our proposed exemption as one for "lower" rather than "low" cost credit because the dividing lines we propose – 18% and 24% – can certainly not be called low rates of interest. But they are sufficiently below MLA's 36% statutory cap that one can say with some confidence that credit below those triggers was not Congress's target, and that it is not the type of credit that poses the problems described in DOD's report on predatory lending.

As we discuss in Section I, allowing an exemption for high cost credit simply because of the identity of the creditor is completely inconsistent with the MLA and with the findings of the DOD's report on predatory lending. Indeed, an exemption for a specific group of creditors is outside of DOD's regulatory authority because it would not be "consistent with the provisions of [the MLA]."[33] Congress enacted the categorical exemptions it intended: mortgages and purchase money loans: The only regulatory exemption consistent with the MLA is one targeted at credit below 36%.

We have strived to develop a workable proposal for a safety zone that gives legitimate lower-cost credit freedom from the MLA's full strictures, makes the 36% cap a reality, and does not have loopholes that would allow high-cost lenders to evade the restrictions. We recognize that refinements would be needed for this (or any other) initial proposal. We trust that mainstream credit providers recognize the importance of effective implementation of MLA for our troops, and hope that they will either help design any such balanced refinements to this proposal, or offer their own safety zone proposal based on price triggers that meet these criteria. We are wedded to achieving these goals, rather than to these specific suggestions for achieving them.

B. Requirements and Exemptions for Credit in the Safety Zone

The only prohibitions that would apply to credit in the safety zone would be:

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[32] See note 38, below for a definition of these "APRs".

[33] 10 U.S.C. §§ 987(D), (E), See Section II, above.

- Using a post-dated check as security
- Requiring an allotment[34]
- Violating the Electronic Funds Transfer Act (including for single payment transactions currently exempt from EFTA)
- Imposing a mandatory arbitration clause on servicemembers
- Requiring a waiver of MLA or SCRA rights.

As described in DOD's predatory lending report, the first three practices are used by predatory lenders as a hammer over Service members trapped in abusive loans, but they are not practices engaged in by mainstream lenders. Both Congress and DOD also made a determination that MLA rights should be unwaiveable, and that mandatory arbitration can be abusive and should not be enforced against Service members. Compliance with these two requirements is a simple matter of putting an exemption for Service members in any mandatory arbitration clause and refraining from imposing a waiver of MLA rights.

With these minimal exceptions, which would not constrain mainstream creditors, credit within the safety zone would be exempt from the MLA, including these provisions:

- Penalties for occasionally and inadvertently exceeding the 36% cap[35]
- Need to identify Service member customers
- Dual TILA and MLA disclosures
- Oral disclosures
- Prohibition on waiver of rights other than MLA or SCRA
- Limitations on refinancing, consolidation, rollovers, renewals.
- Prohibition on auto-title lending
- Prohibition against prepayment penalties

For all practical purposes, mainstream creditors would find that most if not all of their products would be exempt from the MLA, beyond the need to make occasional reductions, upon request, when fees become excessive – a courtesy that lenders already often extend to their customers.

C. Preconditions to Be Within the Safety Zone

We believe that the only credit that satisfies these conditions deserves to be eligible to be in the safety zone:

- The credit given or actually available is significant enough to warrant relief from the full MLA, for example at least $300 of credit;

[34] An allotment is a direct payment by DOD to a creditor, without even passing through the Service member's bank account. It is not the same thing as an electronic payment.

[35] The details of the fee tolerances are discussed below. They are designed to accommodate mainstream practices while setting some limits to avoid abuses and to avoid military credit that consistently and substantially exceeds 36%.

- The term is at least 90 days;

- The credit is payable in substantially equal installments with no balloon payments; and

- The credit is payable no more frequently than the customer's pay period.

There are several reasons for these conditions. First, they are designed to ensure that the most problematic credit practices do not come within the safety zone. Short-term payday loans, or credit with balloon or frequent payments structured so that default is likely, should receive no special protection. Second, any legitimate credit for a period shorter than 90 days should have no reason for not fully complying with the MLA.[36] The interest rate should be under 36% and there will be no need for any of the devices that MLA prohibits. Finally, we have proposed tolerances for certain fees, but those fees would be unreasonable for credit in smaller amounts or for shorter periods of time.

D. The Specific Price Triggers

1. Description of the Price Triggers

We suggest that credit should be largely exempt from the MLA as long as the maximum rate is at or below certain price triggers.

For adjustable rate transactions, or credit agreements that give the creditor discretion to raise the rate, it is important that the safety zone be based on the maximum rate, including any later rate increases. Otherwise the caps could be easily avoided simply by setting an initial lower rate.[37]

We note also that some credit cards carry alternate APRs in some situations (i.e., default or cash advance) above the regular interest rate. Since these credit cards also impose fees in those situations, we discuss the treatment of alternative APRs rates below in the section discussing fees.

a. Open-End Credit Option One: 18% Plus Fees

[36] We are not opposed to refinements that would provide some freedom for truly low cost smaller or shorter term loans, though fees become more problematic in those cases and would probably have to be fully encompassed in the annual rate.

[37] The regulations should address the treatment of variable rate loans. The best approach is to require a cap in the credit agreement for military customers.

We recommend a safety zone for open-end credit products, such as credit cards and lines of credit, that carry an annual rate of 18% or below. Fees would be generally permitted, as long as annual or required fees were under certain caps and servicemembers had the opportunity to request reductions in other fees if they became excessive. (See Section III-1-D, below).

The 18% price trigger is based on the existing Truth in Lending Act APR that must be disclosed in credit card and other solicitations.[38] Since this TILA APR is set by the creditor for its open-end plans, the creditor can easily determine if the credit plan's rate is at or under this cap.[39]

In addition, the creditor would be permitted to charge certain fees that are not included in this TILA APR but will be, we hope, covered by the MLA definition of "interest," such as participation (i.e. annual or application) fees, late fees, cash advance fees, foreign transaction fees, and credit insurance premiums.[40] In order to ensure that such fees are not used as a device to evade the rate cap, we have proposed certain limitations on those fees, discussed separately below, but the limitations are designed to prevent flagrant abuses and to prevent credit from regularly exceeding 36%, not to require changes in existing mainstream practices.

b. Open End Credit Option Two: 24% With No Fees

We also recognize that some lenders offer "all-in-the-rate" products without fees. For obvious reasons, the rates on those products are higher. To accommodate and to encourage providers who offer these more transparent products, we suggest that DOD permit a higher, alternate safety zone of 24% or below for open-end credit that has no fees. Since this higher "safe-zone" rate is, by definition, for no-fee products, the fee-based tolerances we describe below in III-E-1 do not apply. Here, too, the TILA APR disclosed currently on credit solicitations can be used for assessing coverage.

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[38] For purposes of this partial exemption, the open-end 18% and 24% APRs are the "corresponding annual percentage rates" as TILA uses the term. (i.e. If a creditor applies a 1.5% rate monthly to a balance on a credit card plan, that 1.5% "periodic rate" "corresponds" to an 18% annual percentage rate. *See* Reg. Z, §226.2(a)(21) (definition of "periodic rate."). The APR that must be disclosed on solicitations for credit cards and the initial credit plan disclosure is this annualized periodic rate. *See* Reg. Z, § 226.5a(b)(1); §226.14(b).

[39] Bounce loans, which are a form of high cost credit but are not covered by TILA disclosures, would not be exempt. They are discussed, in III-D-1-d, below. An overdraft line of credit would be exempt if it fell within the price triggers.

[40] See SectionV-A-2, below, for a discussion of the MLA definition of "interest."
Cash advance fees and foreign transaction fees are covered in TILA's "historic" or "effective" APR, which can only be calculated based on actual usage. These APRs can only be disclosed after the fact, on the monthly credit card statements. Obviously they are not included in the APR listed on prospective solicitations, though the fees are listed separately.

Such “no fee” credit cards, at somewhat higher rates, are common. For example, Capital One recently sent two separate credit card solicitations (Appx. B) to the same potential customer: one carried a periodic rate of 9.99% but had several fees; the other had a periodic rate of 13.9% but had no late, over-the-limit, or other fees. Even if those rates were substantially higher for a more credit-impaired customer, this example shows how existing mainstream products could avail themselves of an exemption from the MLA with rates as high as 24%.

c. Closed End Credit: 24% Including Fees

We propose that closed end credit be considered within the safety zone, exempt from most of the MLA, if it carries a 24% or less maximum annual rate over the life of the loan, including all fees (beyond a modest tolerance for late and application fees). For most standard loan products, this all inclusive MLA annual rate will be the same as the TILA APR, because the TILA APR for closed end credit has far fewer loopholes than the open-end rate.[41] Nevertheless, we do not suggest simply adopting the TILAAPR to define the safe harbor, however, because the one instance in which the MLA APRI and the TILA APR would most commonly diverge is where “insurance packing” has occurred, which is one of the specific targets of MLA.[42]

We propose that only two fees be excluded from the calculation of the 24% safety zone for closed-end credit: modest application and late fees. The proposed tolerances for those fees are discussed below in the section describing the treatment of fees.

d. Outside the Safety Zone: The Special Case of “Bounce loans”

“Bounce” loans are a form of “revolving credit” identified in the DOD report as a high cost problematic form of credit.[43] Bounce loans are generally recognized as an extension of “credit,”[44] though TILA excludes all overdraft fees from the definition of “finance charge” and therefore from its APR.[45] Because the loans are “credit,” there is no basis to

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[41] See Section V-A, below, for a discussion of the calculation of the fees and charges to be encompassed by MLA’s definition of “interest” and “APRI.”

[42] See DOD Report at pp. 18-19.

[43] One banking treatise refers to “check credit” as simply another form of “revolving credit,” just like credit cards. 1 Barkley Clark et al., *The Law of Bank Deposits, Collections and Credit Cards* § 3.04, at 3-107 (emphasis added).

[44] *See, e.g.* 12 C.F.R. § 215.3(a)(2) (defining overdrafts as “credit” under the FRB’s Regulation O, which governs loans to bank insiders); Daniel P. Stipano, Deputy Chief Counsel, OCC, Interpretive Letter #914, 2001 WL 1090788 (August 3, 2001) (“An overdraft would be “credit,” as defined by the Truth in Lending Act and Regulation Z.”).

[45] Regulation Z excludes overdraft fees from APR and finance charge calculations if the overdrafts are covered on a “discretionary” basis and are not promised pursuant to a prior written agreement. Our

exclude them from the definition of “consumer credit” under the MLA. There is also no basis to treat their costs as unrelated to the price of credit, for the MLA explicitly uses a broader definition of “interest” that clearly includes such fees. (See Section __, below_).

Including overdraft loans in the scope of the MLA is also consistent with the purpose of the Act – and excluding them would be inconsistent with that purpose, and therefore contrary to DOD’s administrative authority. The DOD predatory lending report described the problem of “bounce protection” at rates up to 877%.[46] Experience has also shown that deceptively named “courtesy pay” programs have proven a problem for young, inexperienced servicemembers and can drive them into the same cycle of high fees and negative balances as payday loans.[47]

Banks frequently justify these programs on the grounds that they “avoid embarrassment.” Financial institutions should be required to offer Service members who wish overdraft protection a line of credit or linked credit card at 36% or less, as DOD suggested in its report. If the Service member’s credit is so impaired that he or she cannot qualify for a 36% line of credit, then overdrafts should be denied, beyond a certain set number of courtesy overdrafts, such as three per year. As the DOD report noted:

> It is understood that such an interest rate cap may limit the availability of credit to certain Service members. Limiting high-cost options assists the Department in making the point clear to Service members and their families that high cost loans are not fiscally prudent. [48]

Under our proposal, overdraft lines of credit or linked credit cards are entitled to safety zone protection if they fall under the 18%/24% price triggers. With respect to fee-based “bounce loan” programs, which are not pursuant to a credit agreement and do not have a TILA APR, we propose the following guidelines:

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proposal is true to this line, by exempting the first three discretionary overdraft loans but treating more regular overdraft coverage in the way that Regulation Z treats, ironically, the more acceptable forms of a line of credit or linked credit card – as credit. Reg. Z, § 226.4(c)(3). It is this “written agreement” loophole that made the recent explosion of heavily marketed “discretionary” bounce products attractive to banks. For a discussion of these products, see e.g. Eric Halperin, *et al* Debit Card Danger, supra, note 17 ; Jean Ann Fox & Patrick Woodall, *Overdrawn: Consumers Face Hidden Overdraft Charges From Nation’s Largest Banks*, Consumer Federation of America (June 9, 2005) http://www.responsiblelending.org/pdfs/ip009-High_Cost_Overdraft-0505.pdf; Jacqueline Duby, Eric Halperin & Lisa James, *High Cost and Hidden From View: The $10 Billion Overdraft Loan Market*, Center for Responsible Lending, (May 26, 2005) , available at http://www.consumerfed.org/pdfs/CFAOverdraftStudyJune2005.pdf.

[46] DOD Report at 34-35. And, of course, they fit the characteristics of predatory lending. *See id.* at 21-22.

[47] Mary Cunningham, “Why Our Credit Union Has Wrestled With Realities of ‘Courtesy Pay,’” *Credit Union Journal*, January 17, 2005 (Appendix D).

[48] DOD Report at 50.

- A paper check that bounces (is not paid) is not credit and the fee would not be covered or restricted by the MLA.

- If the bank pays a bad paper check, the first three such overdrafts a year would be considered courtesy pays and could be charged the same, unrestricted fee as a bounced check.[49]

- After three courtesy pays of overdraft paper checks, the product is simply being used as form of revolving credit, and the fee would have to comply with the 36% cap.

- Overdraft fees for ATM and debit card transactions would be fully covered and subject to the 36% cap.

Banks have the ability to deny ATM and debit card overdrafts; if they cover them, they are extending credit just like a credit card and should comply with the 36% cap. There is no justification for charging a $34 fee to cover a $5 overdraft that the bank conceals from the customer. Simply by offering a formal line of credit at or below the 36%, banks could provide the service and remain within MLA's limits.[50]

These guidelines would enable banks and credit unions to continue to offer – and charge for – occasional courtesy overdrafts and to make up to 36% on overdraft credit, but not to profit by and encourage excessive and exorbitantly expensive overdraft borrowing.

2. Rationale for Choosing the 18%/24% Rates

We recommend exempting only credit that is below the rates of 18% plus fees or 24% including fees for several reasons.

Our proposal allows some mainstream fees, and having a cushion between the trigger rates and 36% ensures that those fees will be unlikely to bring the total rate above 36% on a consistent basis. Moreover, the combined decades of experience of the undersigned consumer groups with high cost credit has shown that some providers – particularly the kind extending the credit at which MLA is directed – push aggressively against limits. Without "transition space" between the trigger and the 36% cap, the enforcement efforts become difficult and costly.

Moreover, setting the trigger rate at 36% would effectively repeal the MLA's other provisions. Regulatory discretion does not extend to making large portions of statutes meaningless, as it would be with a 36% price trigger: credit above 36% would be *per se*

[49] We refer to three separate bad checks, not a single check charged three overdraft fees. The rules might limit the bank to a single overdraft fee per day, so that the bank does not manipulate the number of fees by paying the highest check first, resulting in several overdraft charges for the smaller checks.

[50] In a recent survey, only 2% said they would continue an ATM withdrawal if they knew it would cause a bounce fee. *See Debit Card Danger*, *supra* note 17, at 9, 20.

illegal so the rest of the MLA would be superfluous, and all other credit would be exempt from the remainder of the Act, making it hollow.

In designing the specific details of this recommended price trigger, we have looked both at federal laws setting appropriate maximum interest rates, where they apply, and also at common price terms offered on typical unsecured "prime" products, particularly prime credit cards. We have also looked at the history of the "dodges" used by high-cost lenders in the past, and made an effort to try to accommodate the former, while not opening the door to the latter.

We have proposed 18% as the base rate after surveying the mainstream credit products available to military families to ensure that favorable products remain available. Many, if not the majority, of financial institutions on military bases are federal credit unions that have an 18% cap on their interest rates.[51]

Similarly, for two of the biggest banks serving military families, the Armed Forces Bank and the Bank of America Military Bank, all of the credit card and other loan rates are 18% or below. That rate is also high enough to capture nearly all other mainstream lending.

We offer an even higher 24% "all inclusive" rate to provide an incentive and a bigger cushion to creditors who include all of their fees in their advertised rates. That rate is high enough to capture even the highest of mainstream credit products.

E. Fee Limitations For Credit Within the "Safety-Zone"

Though the Department is given the authority to establish a maximum allowable amount and type of fees in the regulation, we focus our discussion on the treatment of fees on credit within the safety zone.[52] Consequently, we focus our discussion of fees as they relate to our price-triggers.

At the outset, we would like to make two background points about our proposal on fees:

First, these suggestions do not signify that we necessarily believe that the fees described below are reasonable or justifiable. Our organizations have long believed that fees are in many cases simply a means of disguising the true costs of credit. (See our further discussion below under the 36% interest cap.) But we are cognizant that the MLA is not

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[51] 12 C.F.R. § 701.21(c)(7)(ii)(B) (1987 until July, 2006). It is currently at 18% by board action, NCUA Letter, 06-FCU-03 (July, 2006).

[52] As we discuss below, Sec, V-A-2, the regulations should define "interest" broadly, to include most fees, as do current federal banking rules. When the 36% cap is all-inclusive of fees, then capping any individual type of fee is not critical to prevent manipulation of fees. A cap is important, however, if the Department decides to exclude any fees from the calculation of interest.

the vehicle for reforming the credit industry. Our proposal is also made with the recognition that (1) there is a perceived need to accommodate mainstream credit practices, and the Department is being urged to entirely exempt federally insured depositories and (2) the MLA dictates only that fees and interest be below 36%, not that they be reasonable.

Second, we offer these suggestions as a starting point for discussion. We developed them after reviewing the advertised terms of several prime mainstream credit products in an effort to accommodate current practices to the extent possible without permitting fees to substantially exceed 36%. Additional "testing" of specifics against both current acceptable practices, as well as unacceptable practices targeted by the Act, is warranted. Such further consideration may reveal ways in which the fee limitations could be simplified while still assuring that fees do not become a tool for misusing safety-zone exemptions.

The treatment of fees as they relate to 18% open-end credit is the primary focus of the following discussion. It represents an effort to balance the need to maintain the integrity of the lower-cost exemptions with the need to assure that creditors acting in good faith do not lose their status if fees occasionally exceed the limits. We then briefly highlight the much more limited allowance for fees in other credit.

1. Fees Permissible for Open-End Credit Of 18% or Less

a. Overview

For open-end credit with an annual rate at or under 18%, we propose allowing lenders to charge additional fees and still fall within the safety zone. However, some limits are needed to ensure that fees are not used as a device to evade the rate cap and that credit to servicemembers does not regularly and substantially exceed 36%.[53]

The rules could itemize a list of allowable charges and set maximum amounts for them, and in fact, we do suggest some specifics in that vein below. The problem with this approach, standing alone, is that while any single fee might appear common or reasonable, added together they could regularly exceed a 36% annual rate by a substantial amount. This is especially true for soldiers stationed overseas, who might pay foreign transaction fees for every charge, or for those struggling with their finances, who are more likely to have late fees and to trigger default rates (and who are the primary reason for the MLA protections).

[53] In section I, we describe an "18.9%" subprime credit card product with a $50 application fee and a $250 credit limit, $175 of which was eaten up by the application and other fees at the outset, leaving only $75 available on the first statement, before any purchases. These limitations would have to be drawn with such evasive devices.

We have attempted to strike the balance. We propose that the regulation specify limits on the fees that are most likely to increase the cost of credit: those that are required and are unavoidable. Other fees would not be individually limited, but a servicemember would have the opportunity to request a refund if, together with interest, they exceeded 3% in a given month.. In creating this approach for the lower rate (under 18%) open-end credit, we considered several factors:

- Creditors can evaluate on a program-wide basis whether a plan falls within the safety net in the first instance.

- Creditors can charge fees without risking civil or criminal penalties if the cost occasionally exceeds a 36% APR in a given billing cycle, provided they offer the refunds.

- By putting the burden on the Service members to come forward to request a reduction if fees add up excessively, the creditor need not identify in advance which customers are military

With those principles in mind, we propose only the following substantive limits on fees on open-end credit at or under 18% APR:

- Annual fees cannot exceed $50/year, or $100/year if the credit limit is $5,000 or higher. No other unavoidable fees are permitted.

- Penalty fees or fees for optional transactions are permitted if the creditor reduces them, upon request, if they exceed $40 (if payment is late)[54] or 3% of the credit balance for the month, whichever is greater.[55]

- The monthly statement must include a general statement that Service members may be entitled to a fee reduction, with the phone number to call.

- Fees may not be designed to evade the price cap.

The explanation for each of these rules is discussed below.

[54] The rules should make clear that this $40 is for purposes of the safety-zone exemptions only, and not an independent grant of authority to charge $40 late fees if otherwise applicable law does not authorize it. For most credit cards, there is no law limiting late fees because of federal preemption, but some providers of open-end credit may be subject to other laws limiting late fees.

[55] We suggest the 3% be applied to the balance to which creditors apply their periodic rate, a figure that now must be disclosed to consumers on their periodic statements. Reg. Z, § 226.7(e). We believe the “average daily balance” to be the most commonly used. Where creditors use other methods of calculating the balance to which they apply their periodic interest rate(s), the rules could authorize substitutions. Also, for open-end credit with periods other than a month, the 3% figure would be adjusted so that when annualized, it did not exceed 36%.

b. *Annual or Application Fees*

The rules should cap annual fees or any other fees that are required under the terms of the credit agreement. These are fees that are unavoidable, must be incurred and are an integral element of the cost of credit. If they were unlimited, the APR cap would be meaningless.

For mainstream open-end credit – credit cards and lines of credit – the only required fee is an annual or application fee. One can imagine other types of required fees, but these would be unusual, most likely tools for padding the interest rate.[56]

We suggested a cap of $50/year, or $100/year if the credit limit is over $5,000, by surveying the mainstream credit card market. Most cards today do not have annual fees (most likely because they are a visible fee that customers compare, unlike the other fees, which are more hidden). Looking at the credit cards on the websites of the two banks and the two credit unions with the most military business – the Bank of America Military Bank, the Armed Forces Bank, the Pentagon Credit Union, and the Navy Credit Union – the annual fees range from $0 (most common) to $49. This is within the range of other prime credit cards as well. We suggest permitting a higher fee for higher limit cards out of recognition that some premium rewards cards carry slightly higher annual fees.

Only one such $50 annual or application fee should be permitted per year per creditor, regardless whether the creditor extends other simultaneous or subsequent lines of credit. This limitation is designed to prevent abuses such as offers of multiple, low balance credit cards, each with a $50/year fee, rather than a single higher limit card.[57] Moreover, once a creditor has reviewed an applicant's application, a second such fee should not be necessary that year for other extensions of credit.

c. *Other Fees and Alternative APRs*

In addition to annual fees, which are unavoidable, credit card agreements also typically impose some other fees, either as a penalty for discouraged behavior or as a charge for an optional service or transaction. As we discuss in Section V below, these fees are

[56] The $50 limit would cover any fees and charges that are required under the terms of the credit agreement and under any other agreement for ancillary goods or services executed simultaneously. Required fees include participation fees, annual or monthly fees, application fees, maintenance fees, documentation fees, or credit check fees, as well as fees for certain goods or services sold in conjunction with or as a disguise for credit, such as credit insurance premiums, catalog sales and auto club membership fees. (The latter category is included because, although nominally optional, "insurance-packing" sales practices are such as to make them *de facto* required. As we noted earlier, these products, used to circumvent existing limits, were a specific target of MLA's reforms.

[57] *See, e.g.,* Cap One's Credit Trap, BusinessWeek Online (Nov. 6, 2006); http://www.businessweek.com/magazine/content/06_45/b4008048.htm

alternative (and surreptitious) ways of charging for the cost of credit and should be considered "interest." Nonetheless, because these fees are difficult to incorporate into an annual rate at the outset of a credit agreement, for lower cost credit at or below 18%, we propose some freedom to charge these fees as long as they do not generally push the annual rate above 36%.

Most – but not all – credit cards carry some sort of late fee, typically $10 to $39.[58] Prime credit card plans also typically carry over limit fees and, less frequently, some other penalty fees, in the same or slightly lower range.[59] Some credit cards also carry a number of fees that are not penalties, imposed for specific uses of the card other than purchase of regular goods or services.[60] In addition to flat fees, some credit cards charge higher APRs in certain situations, such as default of the card agreement or on cash advances or certain other transactions.

We have not proposed individual limits on any of these fees. Instead, if these fees, default APRs, and all other interest cumulatively exceed 3% of the credit balance, (see note 55**,** above) in a given month,[61] the Service member would be entitled to request and receive a reduction. In other words, the creditor would neither violate the MLA nor lose safety zone protection if irregular fees occasionally exceeded a 36% annual rate, as long as the creditor cooperated in reducing those fees upon request. This limitation is needed to ensure that the safety zone exemption is consistent with the MLA as a whole.

We are strenuously against an "opt-in" requirement for all creditors, because it will undermine the effectiveness of the Act. But for credit that is well below the 36% cap, with fees that only rarely and inadvertently exceed that cap, an opt-in requirement is a reasonable compromise that does not frustrate the Act's primary goals.

Although fees and interest would generally be limited to 3% per month, the total could be as high as $40 if the servicemember pays late or otherwise is in default, even if it came to

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[58] As examples:

Navy Credit Union: none
Pentagon Credit Union: $25
Armed Forces Bank: $10
Bank of America Military Bank: $15 to $39

[59] See below, under definition of "interest," for a further discussion of why penalty fees should not be totally excluded from interest calculations.

[60] The cash advance fee is the most common. The Navy and Pentagon Credit Unions charge none; the Armed Forces Bank charges $2 per advance, and the Bank of America Military Bank charges 3% of the advance. Less common special fees, such as those on the Bank of America Military Bank's website, are a 3% fee on foreign transactions, person-to-person money transfers, bets, lottery tickets, money orders, and traveler's checks from a non-financial institution.

[61] The regulations should specify the form this request should take and the creditor's duty upon receiving it. The regulations should also specify the time period that the servicemember has to make such a request, such as one year from the date of the statement showing the excess fees, suspended during any period when the servicemember is deployed.

more than 3% on a small balance.[62] We have proposed this tolerance to accommodate mainstream practices, despite the fact that we disapprove of such large late fees. Note, however, that large late fees are by no means a critical business practice; according to their websites, the Navy Credit Union does not charge late fees on credit cards and the Armed Forces Bank charges only $10.

We have chosen the 3% per month figure because it corresponds to a 36% annual rate. However, DOD may wish to consider another methodology that achieves essentially the same result, such as requiring that the TILA "historic" APR be reduced to 36% with no more than an additional $40 in late fees.[63]

To be entitled to this burden-shifting, the creditor should be required to put a generic notice on its statements advising military customers of their right and the number to call for a fee reduction. **This is an essential provision to ensure that servicemembers know about and can exercise this right.** For example, the monthly statement should prominently display a notice such as:

> NOTICE TO ACTIVE DUTY MILITARY AND MILITARY DEPENDENTS: You may be entitled to a reduction of your fees or interest if they exceed 3% of your average daily balance. To request such a reduction, call (800) XXX-YYYY

Additional awareness efforts, such a conspicuous notices on websites and in facilities located on or near bases, should also be undertaken.

DOD should consider whether the Service member would have to call every month to request such a reduction, or whether the first call would trigger a duty on the creditor to make appropriate reductions in future months.

Although we have not attempted to set limits on individual fees or alternative APRs,[64] DOD has that authority and may find it appropriate to do so. **In particular, DOD should consider banning the foreign transaction fee entirely for Service members.** It is especially pernicious that troops who are stationed overseas serving their country should have to pay an extra 3% on every purchase they make.

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[62] DOD may wish to consider whether this tolerance for the first $40/month in late fees should be allowed if a creditor extends multiple credit lines rather than a single, higher limit credit line. *See, e.g.*, Cap One's Credit Trap, BusinessWeek Online (Nov. 6, 2006). http://www.businessweek.com/magazine/content/06_45/b4008048.htm

[63] The TILA historic APR is the APR disclosed on monthly credit card statements. It includes fees and interest costs, such as cash advance and foreign transactions fees and higher APRs applied to certain balances, that are not encompassed in the primary APR disclosed in credit solicitations. However, it does not include late fees or participation fees like annual fees. Thus, if the historic APR is used as the benchmark, it is essential that it be coupled with the rules that we have proposed limiting late fees to $40/month and annual any other required fee to $50/year.

[64] We would consider an alternative APR above 36% to be an evasion of the Act and a violation of the no-evasion rule proposed below.

We also suggest that DOD either restrict default APRs or strongly urge all creditors to institute a policy of not invoking default APRs for Service members. Default APRs are alternative, higher interest rates that kick in if a credit card holder is in default under a term of the card agreement. For cards that use this device, the terms of the card agreement typically give the creditor wide discretion about when to impose a higher interest rate, including after a single late payment.

As with other fees, we do not believe that use of these default APRs is appropriate.[65] It only makes matters worse to impose higher costs on cardholders struggling with their finances. Default APRs are also very likely to be imposed on and drive up the interest rates for the very Service members that Congress passed the MLA to protect.

Regardless of any arguments for imposing these high default rates on other customers, creditors should work with, and not beat down, Service members who are having trouble paying their debts.

The following are examples showing how the rules we propose would apply.

> *Example 1*: A credit card that has a regular APR of 18% imposes a 3% cash advance fee and imposes an alternative APR of 30% on cash advances. The servicemember is carrying a $500 balance, takes out a cash advance, and makes new regular purchases. The average daily balance that month is $1,000. The monthly statement shows $11.25 in interest on the balance and new purchases, $7.50 in cash advance fees, and $6.25 in interest on the cash advance, for a total of $25 or 2.5% of the $1,000 balance. No reduction would be required because the total is less than 3%.
>
> *Example 2:* The Service member is deployed overseas. He is carrying a $500 balance, and makes $500 in purchases in a foreign currency, and has an average daily balance of $1,000. The monthly statement shows $18 in interest charges and $15 in foreign transaction fees, for a total of $33 or 3.3% of the $1,000 total. Upon request of the servicemember, the card company must reduce the fees by $3.
>
> *Example 3:* The Service member normally pays her card in full each month, but forgot to pay her $300 balance last month. Her monthly statement shows a $15 late fee and $7.50 in interest charges, for a total of $22.50. Though the charges amount to 7.5% of her balance (roughly an annual rate of 90%), they do not exceed the $40 tolerance for penalty fees and thus need not be reduced.

[65] We note that of the two credit unions and the two banks with the largest military customer base, three – the Pentagon and Navy Credit Unions and the Armed Services Bank – do not appear to employ default APRs. Only the Bank of America Military Bank has a default APR on its website: 29.99%, on cards that otherwise carry a rate of 7.99% to 13.99%. Default APRs are also present in many other mainstream credit cards.

Example 4: The Service member has a $5,000 balance, his last payment bounced, he took out a new $500 cash advance, and he made $500 in new purchases in a foreign country. His monthly statement shows $161 in periodic interest, $78 in late and returned payment fees, and $30 in cash advance and foreign transaction fees, for a total of $269 on an average daily balance $6,000. Upon request, his fees and interest would have to be reduced to $180 (3% of $6,000).

d. ***Fees May Not Be Designed To Evade The Price Cap***

The 3% per month tolerance applies only to fees that are both avoidable [66]and are not imposed on the primary use of the card – such as penalty fees, or fees on foreign transactions or cash advances. The only unavoidable fee that is permitted is a $50 annual fee. Thus, a creditor could not impose a $50/month "participation fee" or any other fee that is required as part of the credit agreement.

But even for avoidable fees, DOD should consider rules to ensure that creditors do not design new and higher fees to evade the price cap with the result that fees and interest regularly exceed 36%. For example, one can imagine a card that imposes a 3% fee on restaurant, retail and gasoline purchases. Similarly, a card with a 38% default rate, easily triggered and kept in place for long periods or by stringent conditions, should be considered an evasive practice.

This could be accomplished either by setting limits on the permitted fees, set by surveying the fees in effect now for mainstream lower cost credit, and/or by having a general rule that fees cannot be imposed to evade the price caps. We propose a general no-evasion rule in Section VII, below, and a similar rule should be incorporated into any safety zone.

2. **No Fees Permitted for Open End Credit Between 18% and 24%**

No fees should be permitted on open-end credit between 18% and 24% that wishes the benefit of the safety zone. The higher limit is intended to encompass fees. Many mainstream credit cards have no fees at all, not even late fees, but bear higher APRs than cards with fees.

3. **Fees Permitted For Closed End Credit at 24% or Less**

The second safety zone we propose is for closed end credit at 24% or less with fees included. For the most part, the regulations would not need to specify permitted fees, because for closed-end credit, fees can be determined and figured into the annual rate in

[66] By "avoidable," we mean either depending upon use for a purpose other than a purchase, e.g. cash advance, or a penalty fee, such as a late fee.

advance. Any fee would be permitted as long as it did not drive the cost of credit above a 24% annual rate.

Even for this all-inclusive safety zone, however, we propose tolerances for two types of fees that would be allowed above the 24% annual rate.

First, as with the 18% safety zone, we propose that the creditor be allowed a $50 per year application fee above the 24% interest cap. This tolerance is designed to accommodate reasonably priced small loans that are alternatives to payday loans. Again, each creditor would be allowed to exclude only one such required fee each year, even if it makes additional credit extensions to the same Service member, whether simultaneously or subsequently.

> *Example*: A credit union that charges a $50 application fee for a $300 90-day loan at 18% interest would be within the safety zone. However, the credit union could not charge a second such fee for a second 90-day loan the same year unless the total fees and interest did not exceed 24%. That is consistent with the usual practice for credit union small loans, which typically charge a single annual or application fee covering all credit that year.

Second, we propose that a reasonable late fee be permitted for purposes of the safety-zone tolerance: for example, the greater of $20/month or 5% of the payment.[67] Thus, in the credit union example above, a $20/month fee could be charged for late, missed or bounced payments, even if the balance were down to $100 and the fee translates to an annual rate of 240%.

Beyond these tolerances for application and late fees, other fees would be permitted as long as they did not bring the annual rate above 24%.

F. Application of the Safety Zones

1. Credit Union and Bank Prime Lending, Including Prime Loans, Prime Credit Cards, And Genuinely Low-Cost Small Loans Should Be In The Safety Zone

As applied, we believe that the triggers would enable legitimate low-cost lending, including most mainstream lending, to operate within the safety zone. For example, all Navy Federal Credit Union, Pentagon Credit Union, and Armed Forces Bank credit cards, with terms disclosed on their websites, would fall within the safety zone, as long as

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[67] Again we stress that these MLA allowances for late charges would be only for purposes of determining whether the credit is in the MLA safety zone. If otherwise applicable law (e.g. state small loan laws) have lower limits for delinquency fees, MLA does not legalize those fees. . On the other hand, any other federal law purporting to allow unlimited late charges would not protect those providers from MLA's limits. MLA specifically states that other federal laws which might diminish MLA's protections are themselves preempted. 10 U.S.C. §987(d)(1).

they were willing to reduce their fees on the infrequent occasions when they amounted to more than a 36% rate when annualized (above the tolerances described above). The same is true of most prime credit cards.

Similarly, most federal credit union lending, which already complies with an 18% interest cap, would be in the safety zone, including short-term (90-day) lending and other products.[68] Most traditional bank lending would also be able to available themselves of the safety-zone exemptions.

In unusual cases, where a series of fees added up excessively in a given month to substantially more than 3%, the Service members would be able to request a refund of the fees that exceeded 3% plus any tolerance. But the creditors would have no obligation to identify the Service members ahead of time nor would they risk criminal and civil sanctions under the MLA by initially charging fees that exceed the limits. Even with the reductions, the creditors would be receiving a hefty return in interest, fees and charges that month. Moreover, in most cases, even significant fees would not trigger the need for reductions.

We are certain that mainstream creditors will happily make slight reductions in fees to assist military families who are struggling with their finances, just as they routinely extend the courtesy of waiving fees for other customers. That is the least they can do for military families.

2. <u>Payday-Like Products Would Not Be Exempt</u>

In contrast, Service members would be protected from payday loan-like products, whoever offers them. This would include bank-funded internet payday loans, bank payday advances priced at payday-prices, refund anticipation and pay-stub loans, and some low-limit/high-fee subprime credit card products.

For example, if the regulations exempt all federally insured depositories, Purposeloans.com would be able to continue offering internet payday loans at rates of 350%. Banks will be able to continue offering direct deposit "account advances" at disclosed APRs of 120% and actual APRs of well over 500% for a typical 5 day advance. Banks will also be tempted to develop and expand their payday-like products, just like they were tempted to enter the rent-a-bank payday market.

These abusive products will only be stopped if any exemptions are tied to a price trigger, not to the identity of the creditor.

IV. PROCEDURAL IMPLEMENTATION OF THE ACT

[68] The main exception would be credit unions that charge excessive bounce loan fees.

A. Implementation Date And Effect On Pre-Existing Credit and Credit Prior To Military Status

We first address issues of effective date. Answering these questions in a manner that provides a smooth transition should alleviate many of the concerns that have been raised about the Act's substantive provisions.

The MLA becomes effective on October 1, 2007. This effective date presents the following questions:

- Will institutions have the ability to **phase in implementation** if the regulations are not finalized until close to the effective date?

- What is the **effect on accounts open prior to the effective date**, such as credit cards or bank accounts?

- What is the effect on **credit extended prior to the customer's gaining military or military dependent status**?

Consumer groups support answering these questions in a manner that permits a smooth transition and does not disrupt credit to military families. At the same time, the regulations must remain faithful to the mandates of the Act and the Act's purpose in filling the gap left by the Servicemembers Civil Relief Act.

In general, we believe that the MLA should apply wherever the SCRA leaves off, but that there could be a phase in period in all three situations during which servicemembers or military dependents may be required to identify themselves. Apart from this transition period, however, we strongly oppose an opt-in system, and believe that it would be contrary to the statutory mandate. (See IV-B-1, below.)

1. Phased- In Implementation

The Act is very clear that it takes effect on October 1, 2007, or sooner, and that DOD may enact emergency regulations if necessary to ensure that regulations are in effect on that date. At the same time, institutions have raised legitimate concerns that the specific rules may not be known soon enough to adapt to them by October 1, and that implementation may take some time.

We recommend that the Act and implementing regulations be effective as required on October 1, 2007. However, to ensure a smooth transition and fairness to creditors acting in good faith, **for the first year, and the first year only**:

- No criminal penalties or sanctions voiding an entire loan agreement should be applied if the creditor makes a good faith attempt to comply;

- The burden may be on servicemembers and dependents to identify themselves and to request protections;[69] and

- Good faith will be presumed if the creditor, upon request of a servicemember or dependent, makes appropriate reductions in applicable fees or interest rates or otherwise brings the transaction into compliance with the Act.

After the first year, for reasons described more fully below, we believe that effectiveness of the Act requires creditors to act affirmatively to comply, without a request from the servicemember. For the first transitional year, however, it is reasonable to permit more uneven coverage as institutions adapt their procedures.

2. Effect on Accounts Open Prior to October 1, 2007

The Act applies to "extensions of consumer credit on or after" October 1, 2007. DOD may define what that phrase means. For pre-existing open-end accounts like credit cards and bank accounts that have an overdraft feature, the question arises how to treat purchases, account advances or overdraft loans after October 1. Of course, constitutional limitations on impairment of contract must be observed in determining the extent to which MLA could apply to existing accounts in any event.[70] Subject to those limitations, we offer the following suggestions.

As a general matter, we believe that the SCRA and the MLA should be interpreted consistently so that there is no gap in coverage. The MLA was intended to pick up where the SCRA leaves off – for credit extended after entering military service, to which the SCRA does not apply.[71] To the extent that the SCRA applies to all future extensions of credit on a preexisting account, then there is no concern about a gap in coverage.

We also believe that the regulations should specify the following treatment:

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[69] Of course, there should be strong education and awareness campaigns to assure that servicemembers are aware of their MLA rights.

[70] An exploration of the potential constitutional issues is beyond the scope of these comments. However, we note that overdraft "bounce loans" are not made pursuant to an "agreement." *See* note 45, above. Therefore, there should be no constitutional impediment whatsoever to applying the MLA's provisions to these loans even as to existing deposit accounts.

[71]The comments of the American Bankers Association and other banking associations pointed out: "Protection for loans made and accounts opened prior to active duty is already provided by the Servicemembers Civil Relief Act ("SCRA")…. The maximum interest permitted under the SCRA is 6%, much less than the limit under the [MLA's] section 987(b). Thus, at least with regard to loans made and accounts opened prior to active duty, arguable, 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." We agree, except to the extent that the ABA was giving itself wiggle room to argue that certain extensions of credit made to a Service member from an account opened prior to military service are not covered by the SCRA – either because they are credit extensions made after entering service, or because they are not covered by the SCRA..

- Accounts issued at a bank or credit union **on a military base should be covered immediately by the MLA, subject to a phase-in period to implement the rules.**

- For off-base accounts, **if an account is renewed or its terms are changed,** as when a credit card reaches its expiration date and a replacement card and agreement is sent, or when a change in terms notice is sent, that should be considered a new extension of credit, at which point it becomes covered by the MLA.

- Otherwise, new extensions of credit under a pre-existing account should be covered once the member or dependent comes forward, **self-identifies, and asks that either the SCRA or MLA protections be applied to the account,** whichever is applicable (or that the member be given the opportunity to close the account and open a new one that complies with the MLA).

Banks and credit unions located on military bases of course know that their customers are all military, so there is no issue of identification or of surprise. These institutions have a special obligation to ensure that servicemembers receive the full protections to which they are entitled.

For credit cards or any other type of account with a renewal feature, the appropriate compliance point is upon renewal, when the creditor can easily ask if the customer is military or military dependent, just as on a new application. The same is true when the creditor sends a notice of change in terms; it can at that point conform the terms to the MLA, applicable only to servicemember customers, if necessary. (Of course, under our recommendations, identification would only be necessary for credit that exceeds 36% or otherwise violates the MLA, and is not within the safety zone exemption detailed above in Section III.)

3. Post- 2007 Credit Extended Prior To Military Or Military Dependent Status

After the effective date of the MLA, if an individual opens an account or takes out a loan, and then joins the military or becomes a military dependent, the account or loan should be treated just like credit accounts opened prior to October 1, 2007, as is described in Section IV-A-2, above. The servicemember or dependent should identify him or herself to the creditor and ask that either the SCRA or the MLA protections be applied, as appropriate.[72]

[72] As noted above, a non-spouse dependent, who opened an account covered by the SCRA prior to becoming a military dependent, would not be covered under either Act. Otherwise, either the SCRA or the MLA would apply.

B. **Procedure For Identifying Service Members And Their Dependents Eligible For MLA Protections**

We understand that some financial institutions are asking DOD to use the opt-in rules under the Servicemembers Civil Relief Act to determine eligibility for protection under the law. Except during the initial phase-in period (discussed above), we strongly oppose this opt-in system. The difficulties in identification are more easily addressed than rhetoric would have it.

To begin with, **identification is not necessary where the credit would not violate the Act in any event.** If credit is below 36% and complies with the Act's other ancillary provisions – which may be interpreted, we hope, in a manner that does not materially affect legitimate credit – then there is no need to determine whether a customer is military or not. Whether or not the customer is covered by the Act, the credit is legal.

Under the exemptions that we have proposed, lower cost credit would be exempt from most of the Act, and again would have no need to identify whether the customer is or is not military.

Thus, identification would only be necessary for credit over 36%, or for credit between the 18%/24% safety zone and 36% that is not in compliance with the other provisions. [**note that you should check the preceding sentence to make sure it comports with the final version of the safety zone].** These other provisions will be interpreted in a manner that legitimate credit will have no trouble complying.

[For high cost credit that violates the Act, it does not effectuate either the letter or the spirit of the Act to require an opt-in system. Moreover, simple methods are available to identify and verify military status.

1. MLA Does Not Require Covered Members to Self Identify

Unlike SCRA, the MLA does not require covered members to notify lenders of their eligibility under this new law in order to gain the protection of the Act. The law states flatly that, after the effective date, "A creditor … **may not** impose an annual percentage rate of interest great than 36 percent …."[73] Congress was well aware of the self-identification model of the SCRA and chose not to adopt it. Indeed, Congress even moved the statute from the SCRA title, in which it was originally placed.

There are clear distinctions between the prior debts that consumers hold when they join the military (protected by the SCRA rate reduction to 6%) and credit that is incurred after a consumer is on active duty or otherwise covered. A lender has no way of knowing that a non-military customer will later join the military; conversely, a lender can determine at the time credit is extended whether a borrower is currently in the military.

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[73] 10 U.S.C. § 987(b) (emphasis added); *see also id.* § 987(e) ("**It shall be unlawful** for any creditor to … [engage in certain prohibited practices].") (emphasis added).

The incentive to self-identify is drastically different between SCRA and MLA. In the first case, the consumer is asking to reduce the interest rate on a pre-existing loan which will put more money in his or her pocket. The servicemember already has the credit, and has only to gain by identifying her status.

On the other hand, self-identifying under MLA to a payday lender, car title lender, or other high cost lender will likely mean that credit is not extended by that lender. Military borrowers desperate for cash may go along with a lender's instructions to "check here" that a covered member is not covered.

A self-identification requirement would open up gaping holes in the MLA's coverage for:

- Lenders who induce servicemembers into denying military status;
- Service members who wish to obtain a prohibited payday loan;
- Service members who are too busy with their military service, or keeping a military family going while a parent is away fighting a war, to figure out the paperwork needed to secure the protections of the MLA.

The MLA does not permit Service members to waive their rights under this law. A system relying only on self-identification to lenders would effectively permit them to do so by, voluntarily or coercively, failing to assert their military status.

The regulations should not put the burden on servicemembers to notify their creditors of their status in order to receive protection. Any opt-in requirement would dramatically decrease the number of members covered, undermining the Act itself, and would decrease incentives for creditors to develop reasonable products. Creditors can use a variety of identification methods and application form provisions.

2. Possible methods to identify service members covered by MLA

A number of methods exist to identify eligible service members and their dependents.

Bank Statement: Most Service members are paid by direct deposit of federal pay. Their bank statements show the source of direct deposit pay as "DFAS Cleveland." Payday lenders ask to see bank statements as part of the application process and can easily identify a Service member by the source of direct deposited pay. (Exception: a Service member who has lost his banking privileges and gets a hard check mailed to him.) Payday lenders also typically ask to see an applicant's pay stub to verify a source of employment.

Leave and Earning Statement: Leave and earnings statements (LES) are available online to all Active/Reserve Military and can be downloaded and printed or emailed to creditors. The DOD report described online lenders that required the LES as part of the application process. (Exception: a few Service members have not established the requisite PIN numbers needed to access their LES online.)

Identification cards: It is DOD policy (Department of Defense Instruction: Number 1000.13, Dec. 5, 1997) for members of the Uniformed Services (Army, Navy, Air Force, Marine Corps, Coast Guard, Commissioned Corps of the USPHS and the Commissioned Corps of the NOAA) to be provided a distinct ID card for use in identifying their status as active duty, Reserve, or retired members and as an authorization card for Uniformed Services' benefits. Eligible dependents and other eligible individuals shall also be provided with a distinct ID card to be used as an authorization card for benefits and privileges administered by the Uniformed Services.

- **DD Form 2, "U.S. Armed Forces Identification Card (Active)"** is the primary ID for active duty Uniformed Services' members and is used to identify the member's eligibility for benefits and privileges administered by the Uniformed Services. One version of the card is machine readable. The face of the card includes "active" status designation, expiration date and Social Security Number as well as a photo, signature line and rank/pay grade.

- **DD Form 1173, "United States Uniformed Services Identification and Privilege Card"** is a machine readable card used to identify individuals eligible for benefits and privileges administered by the Uniformed Services, including active duty dependents including Reservists on active duty for more than 30 days. The card includes the Social Security Number, a photo, the sponsor's service and status, rank, pay grade, SSN, name and relationship. At the bottom right of the card face is listed the privileges available to the holder.

Use of either ID card should include all Service members covered by the MLA predatory lending protections, but will also include additional people not covered by the predatory lending protections. It is not a bad outcome for more people to be protected by MLA rather than missing some who should be protected.

DEERS: Defense Enrollment Eligibility Reporting System (DEERS) is a service-wide program that identifies Service members on active duty, all dependent parents and parents-in-law, among many others and is accessed through **DMDC**: Defense Manpower Data Center database. The Bankers request that the DMDC be upgraded so that lenders can monitor for continued eligibility. They also request the database be modified so that it can be queried in batch form. The Department could explore the feasibility of these options.

3. Recommendations

Given the multiple options for identification listed above, we believe that issues of identification can be resolved. We recommend the following procedures.

* *For covered members*: Financial institutions should be required to rely on evidence from the borrower's bank statement, pay stub, leave and earnings statement and/or ID card to identify a prospective borrower as a covered servicemember. Loan applications typically ask for the name of the employer and prudent lenders request at least some identification and documentation. If this documentation shows active duty military status, it should settle the matter. A lender could query the DMDC database to resolve any disputed situation.

A loan application should also ask if the applicant is in the military, on active duty, or a dependent. A dispute between the identification documentation and a check mark on the application should be settled by the paper record.

* *For Dependents:* Loan applications should ask if the applicant qualifies as a covered member for purposes of the MLA. The ID card provides proof. The DMDC database can be queried for the sponsoring Service member.

V. IMPLEMENTATION OF MLA'S KEY SUBSTANTIVE PROTECTIONS

A. The Prohibition Against Credit Exceeding 36% Interest As Defined by the MLA.

The core of the MLA is the admonition that "A creditor … may not impose an annual percentage rate of interest greater than 36 percent …."[74] The implementing rules must be designed to maintain the integrity of that key provision. Central to doing so is the definition of "interest," which, in turn, will determine the MLA's "annual percentage rate of interest," or "APRI."

We note first that the Department is being urged to re-write the statute. It is being asked to define "interest" to mean the same as the Truth in Lending Act's "finance charge," and "annual percentage rate of interest" (a term not found in TILA) to mean TILA's "annual percentage rate." As we discuss below, we do not believe that such a drastic change from the statute is within the Department's discretion. We also note that the operational concerns which seem to underlie some of the criticisms would be significantly reduced by the price triggers we proposed above. Because our limited exemptions from the Act are defined by a lower-cost price trigger, by definition the 36% cap will not generally concern lenders operating within the safety-zone.

1. "Annual Percentage Rate of Interest"("APRI") Defined

Congress clearly intended that the 36% rate cap be applied to a "fully-loaded" price tag for credit, one that captures all costs, including those omitted in TILA. This intent is evidenced by Congress's deliberate use of a term, "APRI," different than TILA's APR.

[74] 10 U.S.C. § 987(b).

Congress in fact specifically incorporated TILA's <u>methodology</u> for calculating an annual percentage rate, yet it did not incorporate TILA's definition of "finance charge" to define the credit costs used to calculate the ARPI.[75] To further reinforce the point, it explicitly cited a more expansive list of fees and charges that are to be captured by the "annual percentage rate of interest," or APRI.[76] MLA's definition of APR supplements the TILA definition with the admonition that "[f]or purpose of this section [the MLA], such term include all fees and charges, including charges and fees for credit insurance premiums and ancillary products" – items that are not included in TILA's APR.[77] For emphasis, the MLA repeats that "such fees and charges shall be included in the calculation of the annual percentage rate."[78]

Moreover, as discussed below, the MLA includes a specific definition of "interest" which is much broader than the "finance charge" used to determine the TILA APR. The only purpose of this definition is to define what is included in the APRI. The word "interest" occurs in only two contexts in the statute. First, it occurs in the phrase "annual percentage rate of interest." Second, it occurs in the introductory provision, which authorizes charging only interest "not specifically prohibited by this section [the MLA]." The only interest prohibited by the MLA is an annual percentage rate of interest above 36%.

Thus, Congress's only purpose for putting an expansive definition of "interest" into the Act was to use it to define the full range of fees and charges covered by the 36% annual cap. Conversely, the only way to read the term APRI to have the same meaning as TILA's APR is to ignore the Act's definition and its use of the term "interest" – as well as the Act's expansive definition of APR. Such a reading would violate the plain meaning of the statute.

Interpreting APRI to mean TILA's APR and "interest" to mean TILA's "finance charge" would also violate a fundamental legal tenet of statutory construction that statutes should be interpreted to give full effect to all of their provisions. As the Supreme Court recently pointed out, courts are "loath" to adopt an interpretation that would "render part of the statute entirely superfluous," reasoning that Congress would bother to specify details if it did not mean those details to have independent effect.[79] Yet Congress's choice to add the words "of interest" to APR and to define the term "interest" would be superfluous if it meant APRI and "interest" merely to have the same meaning as in TILA.

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[75] MLA § 987(i)(4) specifically references 15 U.S.C. § 1601, which is the <u>computational</u> rule. By contrast, it does <u>not</u> incorporate 15 U.S.C. § 1605, which defines the components of "finance charge" used to compute a TILAAPR.

[76] See also Section V-A-2, below, on MLA's more expansive definition of "interest."

[77] 10 U.S.C. § 987(i)(4).

[78] *Id.*

[79] Cooper Industries, Inc. v. Aviall Services, Inc., 543 U.S. 157, 166 (2004).

Finally, limiting the definition of the APRI to TILA's APR is inconsistent with the legislative history and purpose of the MLA. Congress passed the MLA after the Department issued its report on predatory lending. That report specifically recommended that credit to Service members be limited to a 36% annual rate that "include[s] all cost elements associated with the extension of credit," including some that are not in TILA's APR.[80] (We describe in Section I, above, how TILAexclusions may completely distort the concept of the TILAAPR as an accurate price tag, as with the "6% line of credit" which requires a $149 monthly "participation fee."[81])

The Department's rules should not open loopholes explicitly closed by the statute, by authorizing a substitution of the TILAAPR disclosure. This would not be within the scope of the discretionary rule-making authority: they would not be consistent with the letter or spirit of the MLA.

The definition of the terms APR and APRI in the MLA rules should be as follows to implement the clear import and direction of the statute.

> * *"Annual Percentage Rate (APR)" defined:* This term refers to the APR as defined under the Truth in Lending Act and Regulation Z.
>
> * *"Annual Percentage Rate of Interest (APRI)" defined:* This term refers to the cost of credit, including all interest, fees and charges, expressed as a yearly rate. It is calculated using the methodology set forth in 15 U.S.C. § 1606 and regulations thereunder, incorporating all elements of "interest" as defined herein as part of the "finance charge"

2. Definition of "Interest"

The MLA is clear and unambiguous that the term "interest" for purposes of measuring the 36% cap is quite different – and broader -- than the TILA definition of finance charge. As we noted above, Congress specifically referenced the computational provision of TILA, but pointedly did not incorporate by reference TILA's definition of "finance charge."[82] "Interest" includes "all cost elements associated with the extension of credit …." The definition gives no exceptions. TILA's definition of "finance charge," by contrast, contains several exceptions.[83]

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[80] DOD Report at 50 (original emphasis); *see also id. 6, 7; id.* at 34 ("Consumers do not receive Truth in Lending Act cost of credit disclosures for these non-contractual [overdraft] loan products.").

[81] See Sec. I-B, note 24_ and accompanying text, above.

[82] MLA, § (i)(4), specifically references 15 U.S.C. § 1606, which is the calculation rule, but does not incorporate 15 U.S.C. § 1605, which defines the components of "finance charge" for purposes of TILA.
[83] *See* 15 U.S.C. 1605.

As further evidence of this intent to avoid the loopholes in TILA's definition of "finance charge," often exploited by high-cost lenders, the MLA even cites specific examples of charges as "interest" which are not "finance charges" under TILA, such as charges and fees for credit insurance premiums and ancillary products.[84] In doing so, Congress, like the Department, was well aware of the misuse of such so-called "optional" products to disguise the true cost of credit to military personnel.[85] In light of the fact that the explicit statutory language goes beyond the TILA definition, it would not be "consistent with the provisions" of MLA or within the Department's discretionary authority to promulgate a Rule that constricts the statutory definition of "interest."

There are existing definitional models in federal law that can be combined, and, when augmented by specific MLA examples not captured in those models, will meet the clear purpose of the statute to have an all-inclusive definition. This definition would have four elements: The first element borrows from existing definitions of "interest" in rules promulgated by two of the federal financial regulators, the OCC and the OTS. The second incorporates costs captured by the TILA finance charge (some of which are not captured by the OCC/OTS definition of "interest"). The third and fourth specifically articulate the charges mentioned in MLA itself that are not captured by either of the existing federal models.

Our proposed definition is:

> *"Interest defined:"*
>
> [Interest] includes any charge payable directly or indirectly incident to, ancillary to, or a condition of the extension of credit. The term includes:
>
> a. any payment compensating a creditor or prospective creditor for an extension of credit, making available of a line of credit, or any default or breach by a borrower of a condition upon which credit was extended, including, among other things, the following fees connected with credit extension or availability: numerical periodic rates, late fees, creditor-imposed not sufficient funds (NSF) fees charged when a borrower tenders payment on a debt with a check drawn on insufficient funds, overlimit fees, annual fees, cash advance fees, and membership fees.." [86]

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[84] The language uses the term "including," which under traditional principles of statutory construction means that the examples are illustrative, not exhaustive.

[85] *See, e.g.* DOD Report at p. 19. *See also* Section I, listing examples of open-end products with fees not captured by the TILA APR, and note 24, above.

[86] 12 C.F.R. § 7.4001(a) (OCC), interpreting "interest" for purposes of the National Bank Act, 12 U.S.C. 85, and 12 C.F.R. § 560.110(a) (OTS), interpreting the term for purposes of the Home Owners Loan Act, 12 U.S.C. § 1463(g). We do not recommend capturing the last sentence of these federal banking regulatory definitions of "interest" because they exclude some fees clearly intended to be covered by MLA (e.g. credit insurance), and even some included in the TILA finance charge. The omitted sentence lists specific exclusions from the definition: Interest "does not ordinarily include appraisal fees, premiums and

b. all fees which constitute a "finance charge" as defined in Truth in Lending Act, Regulation Z, 12 C.F.R. § 226.4(b);

c. credit insurance premiums, whether "optional" or required;[87] and

d. all charges and costs for ancillary products sold in connection with or incidental to the credit transaction.

We note that the first prong, the federal banking regulators' definition of "interest," includes some fees which TILA excludes, such as "late fees." We believe they must be captured in the definition of interest for purposes of the 36% APRI cap, but we do suggest some flexibility regarding late fees for credit in the safety zone, as described in Section III, above. We also suggest that DOD may wish to explain in commentary to the regulations that the provision for the cost of credit insurance and ancillary products encompasses items like auto club memberships or phone cards, and so forth that are tacked onto or sold contemporaneously with the credit agreement, regardless whether they are technically optional.

The rationale for the federal banking regulators' broad definitions of "interest" that we recommend incorporating into the MLA definition was stated best by the banks themselves. Citibank and the American Bankers Association in their briefs supporting the regulation before the Supreme Court, said that these fees "must be counted against a state ceiling on 'interest' ... otherwise, state limitations on 'interest' could be evaded with impunity."[88] Flat fees like late fees and periodic interest rates "are interdependent as a matter of both law and economics" and both are a form of "loan compensation."[89] For example, the same creditor recently sent two different, separate credit card solicitations to the same potential customer; one carried a periodic rate of 9.99% but had late fees, one had a periodic rate of 13.9% but had no late, over-the-limit, or other fees. Thus, it is clear that even penalty fees like late fees are calculated to cover the cost of credit, not merely to punish bad behavior.

This broad definition of interest also covers newer fees like "foreign transaction fees" that may fall especially heavily on servicemembers deployed abroad and are merely a device for disguising the true interest cost of credit.

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commissions attributable to insurance guaranteeing repayment of any extension of credit, finders' fees, fees for document preparation or notarization, or fees incurred to obtain credit reports."

[87] The MLA's definition of "interest" includes "credit insurance premiums" whether they are single- or multiple-premium, and whether they are required or technically optional, *see* 10 U.S.C. § 987(i)(3), and the regulations should do the same, otherwise this statutory mandate will be evaded.

[88] Brief for the Respondent, *Smiley v. Citibank*, No. 95-860, 1996 WL 143294 (Mar. 29, 1996).

[89] *See* Amici Curiae Brief Of American Bankers Association *et al.*, *Smiley v. Citibank*, No. 95-860, 1996 WL 144104 at *6 (Mar. 29, 1996).

We believe that these fees should be part of MLA's "all-inclusive" definition of interest for purposes of the 36% cap, just as they are in the OCC/OTS definition. However, their inclusion in the 36% cap should not significantly affect low-cost providers, because the proposed low-cost exemption would allow certain fees within the limits prescribed. By combining this all-inclusive definition with the clearly-articulated price and fee safety-zone, the rules can achieve the balance between accommodating legitimate providers of low-cost credit and maintaining the integrity of the statute.

3. Charging the rate "as agreed" under the MLA

Banking trade associations have argued that the provision of §987(a) would preclude lowering interest rates or fees once an account is opened because of the provision requiring that interest be paid "as agreed to under the terms of the statute." [90] That argument is specious. In the first place, that provision is little, if anything, more than an articulation of the most basic of common law contract principles. In both open-end credit (including credit cards) and closed-end credit, contracts frequently provide for variations on rates and fees upon the occurrence of specified circumstances. Credit cards, for example, in the initial contracts, specify that rates will increase upon certain events, including delinquency. Any variable rate contract specifies a rate change upon the occurrence of a change in the index designated in the contract. Some closed-end credit products include in their initial contracts "rate-rewards" provisions, which allow for lowered rates to reward consistent, prompt repayment. Credit card contracts are already drafted to give virtually unlimited discretion to the issuer, typically invoked to raise rates now. [91] There is no reason that contracts cannot provide as easily for 'rate-lowering" events as they currently do for "rate-rising" events. However, if necessary, the rules could easily specify that rates may be lowered even if there is not a specific provision addressing that in the contract.

D. Disclosures

1. Disclosure of an Inclusive APR

Under our proposal, credit within the price-triggered safety zone would be exempt from providing the dual MLA and TILA disclosures and the oral disclosure requirements.

For transactions above the price triggers, where the charges are such that the TILA APR and the MLA APRI are the same, a single disclosure may be made, utilizing the TILA format and terminology.

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[90] Bank Trade Association Letter, p. 20-21.

[91] In addition to contract provisions which provide for raised rates in the event of late payments, "universal default" or other events, the contracts generally reserve to the card-issuers the right to change any term whatsoever for any reason whatsoever with just 15 days notice. These are distinct from the contract provisions which authorize at the outside defined changes that will occur upon defined triggers.

For the prospective disclosures on open-end credit, the TILA format and terminology should also be used, due to the difficulty in calculating an annual rate for flat fees that are uncertain to be imposed. Thus, the disclosure would be calculated as it is for the TILA APR, and the charges for all other fees would be disclosed as they are under TILA currently.

For closed-end credit and for the "historic" disclosures on open-end credit statements, if the TILA APR and the MLA APRI diverge, the dual disclosure could explain in simple terms the difference. (To the extent that a simple explanation does not dovetail with existing TILA rules, the FRB has the authority to make adjustments to TILA itself, and should do so.[92])

> Annual Percentage Rate _________ %. The cost of credit, *excluding some fees*, expressed as a yearly rate.
> Annual Percentage Rate of Interest ___%. The cost of credit, *including all fees*, expressed as a yearly rate.

Such a dual disclosure will not be confusing to consumers or servicemembers unless creditors choose to make it that way. Thus, the regulations should specify the form of disclosure to be used. In particular, the APRI disclosure should <u>not</u> include any reference to the military, such as "military APR." The all-inclusive APRI is an accurate description of the interest cost of the credit for all borrowers. Including a reference to the military would create just the result that some of the financial institution comments have warned: a belief that military are being charged a higher APR.

<u>2. Oral Disclosures</u>

Credit extended under the price trigger would be exempt from the oral disclosure requirement. For other credit, the rules may provide that oral disclosures are required when a loan application or a loan is consummated in a face-to-face transaction. Transactions conducted exclusively by mail or over the internet could either be exempt, or the rules could mandate that the creditor provide a toll-free telephone number to call for oral disclosures. On telephone menu applications, the menu should provide an option for the caller to obtain the oral cost and obligation disclosures.

The regulations could specify that oral disclosures may be limited to the essential terms of the agreement, in particular the fully-loaded annual percentage rate of interest. It would also be appropriate for the regulations to <u>prohibit</u> oral representations that

[92] Current TIL rules require that certain mandatory TILA disclosures for closed-end credit, including the APR, be segregated from all other disclosures , Reg. Z, § 226.17(a)(1) and that the TILA APR disclosure use that phrase, and descriptive words, such as "the cost of your credit as a yearly rate." Reg. Z, § 226.18(e). However, the FRB is given the authority in 15 U.S.C. § 1632 to "permit the use of terminology different from that employed" in TILA if it conveys substantially the same meaning. It also has authority to provide for exceptions for any class of transactions as are proper to effectuate its purposes – of which disclosing an accurate price tag is paramount. 15 U.S.C.§ 1604(a).

contradict the written disclosures, such as a statement that the annual rate of interest is not the real interest rate.

C. Prohibition on Mandatory Allotment

1. The Act Prohibits Mandatory Allotment, But Does Not Preclude Genuinely Voluntary Allotments Nor Beneficial Financial Incentives.

High-cost lenders have required their military customers to agree to divert a portion of their military pay directly to loan repayment. Even when ostensibly "voluntary," the practice is such as to belie the notion of choice, such as treating revocation of the allotment as a default. One lender even set up the allotment so that it did not automatically end when the loan was repaid. If the Service member didn't keep a close eye, or did not understand that the lender was continuing to take his or her pay despite the fact the debt had been paid, and did not affirmatively took steps to cancel it, the lender continued to take the money. Adding insult to injury, the lender then charged a monthly "account maintenance fee" to keep funds it had no right to take in the first place.[93]

It is by no means unusual for legislation or regulation to prohibit non-revocable, mandatory diversion of income or deposit assets as a condition of receiving credit. Existing law prohibits enlisted personnel from assigning military pay, just as many states prohibit non-revocable wage assignments.[94] For thirty years, the federal Electronic Funds Transfer Act has prohibited conditioning the extension of credit on an agreement to repay by recurring electronic funds transfers.[95] This MLA prohibition is modeled on that long-standing EFTA analog.

We are not aware of any mainstream lenders that currently require allotments. Notwithstanding, there have been predictions that this provision could interfere with programs like student loans, which offer lower interest rates for preauthorized electronic repayment agreements. As we discuss below, there is a distinction between "allotments" and "electronic funds transfers," which, as we understand, are the basis for many, if not most, of such programs. Even so, MLA § 987(e)(6) does not preclude genuinely <u>voluntary, revocable</u> allotments. Furthermore, the Federal Reserve Board has interpreted the analogous EFTA prohibition to permit legitimate financial incentives, such as

[93] Letter from Frank Fox, Majors and Fox, LLP, to Jean Ann Fox, Consumer Federation of America, (January 3, 2005), *on file with recipient.*

[94] 37 U.S.C.A. § 701(c). For prohibitions on non-revocable wage assignments, see, e.g. 16 C.F.R. § 444.2(3). Some state laws restrict or prohibit non-revocable wage assignments, *see, e.g* Iowa Code § 537.3305 (forbidding wage assignments as payment or as security).

[95] The Electronic Funds Transfer Act forbids creditors to "condition the extension of credit…. on repayment by means of preauthorized electronic fund transfers." 15 U.S.C. § 1693k; Reg. E, 12 C.F.R.§ 205.10(e)(1). [The terms "preauthorized" and "electronic fund transfers" have specific definitions under EFTA that limit the application of this law].

discounted rates, for electronic repayment, so long as there are other choices.[96] Simply by tracking existing interpretations to EFTA's anti-compulsion provision, the DOD rules may assure that a major goal of MLA is achieved. (Of course, such incentives cannot be used as a device to evade the prohibition against mandatory waiver. See Section VIII, below.)

2. The Rule should specify that the Service member has a right to cancel voluntary allotment agreements.

In order to assure that any "voluntary" agreement to repay by allotment is just that, the rules should also specify that the Service member has an absolute, unconditional right to cancel any voluntary allotment at any time, without adverse consequences.[97] The rule should also assure that the creditors do not place any undue hurdles on the exercise of that right. EFTA again provides a possible model for adaptation. It provides that consumers can cancel a preauthorized electronic funds transfer orally up to three days before it is scheduled to occur, though the financial institution may request a written confirmation of the request in writing within 14 days.[98]

3. The Definition of "Allotment" / "Direct Deposit" distinguished

The statute, by its terms, prohibits mandatory "allotments," a term which already has a specific definition within Department of Defense rules. Some providers of lower-cost credit have expressed concern that this provision would preclude some of their programs which require direct deposit of pay into deposit accounts. If the definition of "allotment" in the MLA rules incorporates the existing DoD definition, such programs would be unaffected by the prohibition against compulsory allotments.

An "allotment" is "a definite portion of the pay and allowances of a person in the Military Service, which is authorized to be paid to a qualified allottee." 7A DoD Financial Management Reg. Allotments, therefore, bypass the Service members' deposit accounts in their bank. For this reason, allotments are not currently subject to the existing EFTA prohibition against compulsory electronic repayment of loans that we described above.[99]

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[96] Official Staff Commentary to Reg. E, § 205.10(e) ¶10(e)(1)-1.

[97] Current EFTA interpretations do not specify how the lower interest rate offered as an incentive for automatic electronic repayment agreements operates when a consumer exercises the right to revoke the automatic repayments. We would recommend that DoD consult with the FRB, and that MLA and EFTA be interpreted consistently with respect to this situation. Of course , as we note above, the incentive should not be such as to eviscerate the prohibition against mandatory allotments.

[98] 15 U.S.C. § 1693e(a); Reg. E, § 205.10(c).

[99] An allotment does not fall within EFTA's definition of an "electronic funds transfer," because it is not processed through the Service members' checking or savings account. Official Staff Commentary to Reg. E, § 205.3(b)-2(i) (payroll allotment, deducted from salary, to a creditor that does not go through the customer's asset account is not an EFT).

By contrast, "direct deposit" of military pay into a Service member's checking or savings account is an "electronic funds transfer" currently subject to EFTA.[100] As we mentioned above, EFTA has long prohibited creditors from requiring that consumers agree to repay the loan through electronic transfers, though there is a loophole for single-installment loans.[101] We do not believe that the prohibition against mandatory allotments should have negative impact on the existing lower-cost alternatives.

We recommend that this prohibition against compulsory allotment apply to all loans, including those under the price trigger. It is vitally important to Service members, and should have minimal, if any, impact on current mainstream lending practices.

D. Prohibitions on Specific Security Methods

1. The Prohibition Against "Access to Deposit Accounts" Requires that the Rules Address Access Through Both Checks and "Electronic Funds Transfers,"

Inextricably linked to the burden of high-cost lending in the first instance is the utter loss of control over their income and their bank accounts faced by service personnel due to the abusive collection practices of those lenders.

As a practical matter, service personnel must maintain a bank account for direct deposit of their military pay. Consequently, bypassing banks to forestall creditor abuse of access is not a realistic option as it might be for civilians. Moreover, military values stress financial responsibility, one factor that led the high-cost lenders to target this market at the outset. Yet the standard operating procedure for one segment of this market is, in very real terms, a business model based on "cold" checks – not a sound financial management tool under military (or civilian) values.[102] Technology has given these lenders additional tools besides the paper check to access Service members' bank accounts repeatedly, and the existing laws that govern electronic banking have loopholes that these lenders have exploited.

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[100] Reg. E, § 205.3(b)(3).

[101] EFTA prohibits the compulsory use of "preauthorized" electronic funds transfers. "Preauthorized" EFTs are EFTs "authorized in advance to recur and substantially regular intervals." 15 U.S.C. § 1693a(9); Reg. E, § 205.2(k).

[102] The modern payday loan market is based on the "cold-check" model, that is, a check written on insufficient funds. In the payday loan "deferred deposit" model, the creditor takes the check (post-dated or not) as a combination promissory note/security agreement/ and payment method, knowing there are insufficient funds in the account. *See generally* National Consumer Law Center, *The Cost of Credit*, 7.5.5.3 (3d Ed. 2005).

Some methods of access are now subject to protections under the Electronic Funds Transfer Act, such as the right to stop payment on recurring electronic debits authorized in advance to pay debts.[103] However, here, too, there are loopholes in the EFTA which high-cost lenders have exploited. One is that checks and related devices do not fall under EFTA at all. Another is that the right to cancel, like the prohibition against compulsory use, does not extend to single payment loans.[104] The MLA seeks to close such loopholes.

To accomplish this, MLA makes it "unlawful for any creditor to extend consumer credit" to a covered member in which it "uses a check or other *method of access* to a deposit, savings, or other financial account maintained by the borrower….as security for the obligation."[105]

To fully realize MLA's purpose in this regard, the rules must address all methods used to access the deposit accounts – both checks and related methods as well as debit arrangements which now fall through EFTA's cracks for other reasons. The evil that the MLA is addressing is the practice of certain predatory creditors, such as internet payday lenders, of gaining electronic access to the Service member's account and prohibiting the Service member from revoking that access, whether through a check, or through debit authority that qualifies as an "electronic funds transfer" under the EFTA."

An example from a legal services attorney demonstrates why MLA sought to assure that Service members have the right to protect their control over their deposit accounts against a range of methods of access: Borrowers who exercised their statutory right to cancel the electronic repayment by "electronic funds transfer" under the EFTA, found that the lender simply prepared a demand draft (a version of a paper check they can create themselves, not subject to EFTA at all) and used that to access the account.[106]

While these provisions have been the target of criticism as potentially impairing access to beneficial credit, we believe these criticisms are overstated. First, most legitimate lenders do not, and have not engaged in the prohibited conduct. Second, to the extent that some flexibility is needed, the rules can easily provide it without compromising MLA goals. Finally, to the extent that MLA merely closes loopholes in existing law, the incremental difference in compliance costs should not be significant.

2. Prohibition against holding a check and similar methods of access to deposit accounts as security

[103] 15 U.S.C. § 1693e(1); Reg. E, § 205.10(c).

[104] A check is not an "electronic funds transfer" at all, 15 U.S.C. § 1693a(6); Reg. E, § 205.3(c)(1). Where repayment would be by means of a debit that does constitute an "EFT", it is excluded from the right to stop previously authorized automatic debits because of the single-payment loophole. See note 102, above.

[105] MLA § 987(e)(5). It also precludes taking a non-purchase money security interest in a vehicle, which we address separately in V-D-4, below.

[106] E-mail t from Community Legal Services attorney, Philadelphia, Jan. 29, 2007, on file with authors.

a. The rules should prohibit taking or holding checks or equivalent remotely-created debit items except as immediate payment.

The abuses associated with high-cost lenders' use of a "cold check" as a combination payment method and security, such as repeated presentment and threats of criminal prosecution, are well documented.[107] It is not a practice that mainstream lenders engage in, for the simple and sound reason that it is antithetical to the kind of sound financial management that is so important to Service members in their military careers. The prohibition against taking a check for any reason other than immediate payment should be absolute.

This prohibition should apply to all military lending without exception. This is one of the key protections in the MLA, and there is no countervailing positive use of checks and similar devices in the mainstream lending market which warrants accommodation.

b. The definition of "check" for purposes of this prohibition must include related devises such as demand drafts, telechecks, etc.

The MLA prohibits the use of a "check or <u>other method</u>" of access to a bank account as security in part because electronic variants have been used to make it impossible for Service members to revoke consent to lenders to access their account. One of the witnesses at the Senate Banking Committee's hearing told of a Service member whose account had been debited 11 times in one day.[108] A contract used by one internet lender appears to allow customers to revoke the debit authority, but goes on to effectively prohibit them from actually doing so.[109] Such a lender can debit the account with impunity through the use of demand drafts or similar mechanisms which do not require the Service member's signature.

Consequently, the definition of "check" must encompass both paper checks and modern equivalents such as telechecks, preauthorized drafts, and demand drafts. All of these have been misused to deplete Service members' bank accounts and to cause excessive NSF fees. The definition could borrow from existing sources. For example:

> * The Uniform Commercial Code defines the term " 'remotely-created consumer item" to mean an item drawn on a covered person's account which is not created by the payor bank and does not bear a handwritten signature purporting to be the signature of the drawer.'"[110]

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[107] *See, e.g.* Lynn Drysdale and Kathleen Keest, *The Two-Tiered Financial Services Marketplace*, 51 So. Car. L. Rev. 589, 610 – 612 (2000).

[108] Testimony of Lynn Drysdale, Senate Predatory Lending Hearing, *supra* note 23.

[109] Jean Ann Fox, Anna Petrini, *Internet Payday Lending*, p. 34 (Consumer Federation of America, November 30, 2004).

[110] UCC Article 3-103(16).

* The Federal Reserve Board Regulation CC defines a “remotely created check” to mean “a check that is not created by the paying bank and that does not bear a signature applied, or purported to be applied, by the person on whose account the check is drawn. For purposes of this definition, "account" means an account as defined [elsewhere in the section] as well as a credit or other arrangement that allows a person to draw checks that are payable by, through, or at a bank.”[111]

3. Prohibition against “access to deposit accounts by means other than checks and related devices as security should encompass the right to cancel electronic debit authorizations.

As we noted above, EFTA has long made it illegal for creditors to require that consumers agree in advance to repay loans by automatic, recurring electronic funds transfers.[112] Voluntary agreements for electronic repayments may be revoked.[113] In short, EFTA provides borrowers with the choice of method of payment. However, high-cost, small loans are typically constructed as single payment loans, notwithstanding their frequent renewals, to take advantage of the singe-payment loophole in these EFTA rights.

By closing the EFTA loopholes, we do not believe that the existing lower-cost alternatives need be negatively affected, with appropriate regulations. As with the prohibition against mandatory allotment, such a rule would assure that Service members retain control over the integrity of their bank accounts. However, we are aware that some of the lower-cost small loan alternative programs offered by banks and credit unions include as an integral part of the product design a mandatory, linked savings components. We understand that these programs currently may include a security interest in these linked savings accounts. Because we believe that such programs, with a strong emphasis on savings, are consistent with MLA’s goals, we suggest that the Rules specifically permit a security interest in such an account, as long as it is narrowly drawn to avoid creating an unintended loophole.

Adapting from the EFTA model and relevant interpretations, the DOD regulation should provide as follows:

1. No creditor may condition the extension of credit to a covered member on the member’s agreement to repay by automatic electronic debits to his or her asset accounts.

   a. A creditor may offer financial incentives, such as reduced interest rates, to encourage automatic repayment.

[111] Reg. CC, 12 C.F.R. § 229.2(fff).
[112] 15 U.S.C. § 1693k; Reg. E, § 205.10(e).
[113] 15 U.S.C. § 1693e(1); Reg. E,§ 205.10(c).

b. A creditor may require direct deposit as a condition of eligibility for a loan, unless otherwise prohibited by law.

c. This provision does not prohibit a creditor from taking a security interest in new savings that are accumulated as an integral part of a credit agreement.

2 A covered member who has voluntarily consented to repay an extension of credit by one or more automatic electronic debits may withdraw such consent and stop payment by notifying the financial institution holding the account orally or in writing at least three business days before the scheduled date of transfer. When consent has been withdrawn, the creditor may not create a demand draft or use any other form of account access device to unilaterally withdraw funds from the covered member's account.

We do not believe that an implementing regulation as suggested above would significantly affect the current lower-cost alternative small loan products with linked savings plans which are taken as collateral, and therefore recommend that it apply to all creditors.

4. Prohibition against car titles as security in non-purchase money transactions

Because car title loans place the Service member's transportation and assets at risk for relatively little money at very high prices, these are specifically targeted by MLA, and properly so. The regulations should make clear that the prohibited auto-title lending does not depend on the particular form in which the lender has access to the vehicle as security, such as whether it holds the title or keys to the vehicle. For example:

> A creditor may take a security interest in a vehicle except as authorized [herein]. For purposes of this section, "security interest" includes taking keys or title to a vehicle as security for the obligation, including but not limited to the actual or constructive possession of the title to the vehicle.

We recognize, however, that some lower cost providers do take vehicle equity as added security, and that these lower cost loans can be beneficial to Service members. We believe that it is within the Department's discretion to permit non-purchase money security interests in vehicles in connection with low-cost loans as consistent with MLA. Thus, our recommendation is that creditors offering credit within the price-triggered "safety-zone" would be exempt from this prohibition.

E. Refinancing and Consolidation

The most pernicious effect of the high-cost lending is the self-feeding, treadmill effect, where unaffordable loans are renewed with a new round of fees that simply makes the debt even more impossible to repay. While first attracting attention in the traditional payday loan context, this treadmill problem is by no means limited to that context. As noted in Section I, some banks have extended high-cost "account-advance" loans 12 –18 consecutive times. The average number of payday loans is 9-12.[114] "Bounce loans," described in one bank treatise as simply another form of "revolving credit," [115] similarly involve repeat usage for a significant minority.[116] As one credit union serving the military found, fees for "courtesy pay" add up quickly, creating a "downward spiral" and a "dependency on the product, similar to the 'rolling' of a payday loan."[117]

Congress and DOD were well aware that existing law has tried several different approaches to stop the treadmill, none of which has yet proven effective. The Congressional effort to do so is found in the MLA's provision making it unlawful for a creditor to take repayment of credit extended to the borrower with the proceeds of a subsequent loan, whether by means of a roll-over, renewal, refinance, or consolidation.

Though the anti-renewal provision is central to enabling Service members to get off the debt treadmill of high-cost debt, we do not believe that Congress intended to interfere with beneficial, cost-lowering refinancings. We also believe that §987(h)(2)(E) provides adequate discretion to the Department to develop regulations which define "criteria and limitations…. appropriate and consistent" with MLA. For example, the Department could limit the prohibition to refinancings that require new fees or higher interest rates, or conversely could exempt from the prohibition refinancings that lower interest rates, when any new fees and charges are added in. [118]

F. Prepayment penalties

Prepayment penalties are commonly prohibited in non-mortgage consumer lending already, [119] and there is no legitimate reason to force a Service member pay a penalty for

[114] See note 6, above.

[115] 1 Barkely Clark, et al, *The Law of Bank Deposits, Collections and Credit Cards* §3.04, at 3-107.

[116]Jaqueline Duby, et al, *High Cost and Hidden From View: The $10 Billion Overdraft Loan Market, Center for Responsible Lending, (May 26, 2005), available at http://www.responsiblelending.org/pdfs/ip009-High_Cost_Overdraft-0505.pdf.*

[117] Mary Cunningham, "Why Our Credit Union Has Wrestled With Realities of 'Courtesy Pay,'" *Credit Union Journal*, January 17, 2005.

[118] Some states have standards for refinancing in the mortgage context which could be adapted, as well.. *See, e.g.* N.C. Stat. § 24-10.2(c); Ohio Rev. Code §1345.031(12).
[119] *See* National Consumer Law Center, *The Cost of Credit*, § 5.2.1 (3rd Ed. 2005)

good money management to get out of debt or refinance with a lower cost credit provider. There is no reason for the rules to do anything except reinforce this absolute prohibition.

We have not proposed that this provision be among the few that apply to lower cost credit because prepayment provisions are generally not a problem in such agreements.

G. Definitions of "Creditor" and "Consumer Credit" Subject to the Act

MLA specifically gives the Department of Defense the authority to define the key terms "creditor" and "consumer credit," which will ultimately determine the scope of coverage for MLA. The Act provides that its terms apply to a "creditor" that extends "consumer credit."[120] Except for two specific statutory exclusions, the definition of the term "consumer credit" is within the Department's regulatory authority, subject only to the requirement that it be consistent with the goals of the Act.[121] A "creditor" is one who is "engaged in the business of extending credit," and meets any additional criteria that the Department specifies in the regulations, as well as the assignee of such creditors.[122]

We discussed in Section I our strong opposition to any effort to exempt certain categories of lenders from the MLA through restrictive definitions of "creditor" or "consumer credit." Past experience has amply demonstrated that even regulated depository institutions have been active in promoting the kinds of high cost lending specifically identified in the DOD report. Furthermore, categorical exclusions simply provide an easy roadmap for those who wish to evade the Act's requirements in the future. The high-cost lenders have been remarkably creative in their efforts to evade existing law. The regulations should not make it easy for them to do the same with the MLA.

1. Definition of "Creditor"

Under our principles, this term would be broad, and would not exclude any classes of providers. Both state and federal law provide different models for adaptation. In order to assure that the MLA's goal of including assignees is covered, we believe that adapting from models in such statutes as, for example, the Equal Credit Opportunity Act (ECOA), 15 U.S.C. § 1691b, or the Uniform Consumer Credit Code (UCCC),[123] would be better

[120] MLA, § 987(a), (e).

[121] MLA, §987(i)(6); Section II, above.

[122] MLA §987(i)(5).

[123] Uniform Consumer Credit Code 1-301(17)[1974], 7A Uniform Laws Anno. (West); enacted, e.g. Iowa Code § 537.1301(17).

suited to the MLA than the definition under the Truth in Lending Act (TILA).[124] The following definition is adapted from those models.

Definition of Creditor:

A person who regularly extends, renews, or continues consumer credit, or an assignee of such person.

2. Definition of "Consumer Credit"

Existing models in state and federal consumer protection law define this term very broadly. We do not believe our servicemen and women deserve more restrictive definitions, particularly since this definition controls what credit will be subject to the Act. We believe that our price-trigger safety-zone obviates any perceived need to restrict the scope of the Act's coverage through this definition.

As with the terms "credit" and "creditor," existing law offers readily adaptable models for the term "consumer credit."

a. Credit

Defining "credit" is the precursor to defining "consumer credit." That definition is similar in many models, including the ECOA, TILA, and the UCCC. For example:

"The right to defer payment of debt, to incur debt and defer its payment, or to purchase [property or] services and defer payment therefore."[125]

A broad definition such as this helps prevent the use of disguised forms of credit intended to evade the law, as the Department could clarify.

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b. Consumer Credit

As with the term "credit," there is remarkable similarity among existing models. Generally, it is simply

"Credit" [as defined above] offered or extended for personal, family or household purposes.[126]

[124] The Truth in Lending Act's definition of "creditor", 15 U.S.C. § 1602(f), is not a good model for a MLA definition, as it is both under-inclusive, given the plain language of the statute, is unnecessarily complex, and is one of the "recipes" too often used by providers seeking to evade the law.

[125] *See, e.g.* UCCC 1-301(15) [1974]; 15 U.S.C. § 1691a(d); Reg. B, §202.2(j) (ECOA): 15 U.S.C. § 1602(e), Reg. Z, § 226.2(a)(14) (TIL).

3. Statutory exclusions from the definition of "consumer credit"

The MLA itself mandates only two exclusions from the definition of consumer credit: residential mortgages, and secured credit financing the purchase of personal property.[127]

a. "Residential mortgages"

While some have suggested that the Rules should exclude all real-estate secured mortgages, certainly a 40% home equity loan would be at least as significant a financial burden on a Service member as a high-cost small loan. TILA defines "residential mortgage transaction" to apply only to financing the initial acquisition or construction of the home. For consistency and simplicity, we recommend that MLA regulations adopt the TILA definition of residential mortgage transaction.[128]

> "A transaction in which a mortgage, deed of trust, purchase money security interest arising under an installment sales contract or equivalent consensual security interest is created or retained in the consumer's principal dwelling to finance the acquisition or initial construction of that dwelling."

Refinancing and home equity loans and lines of credit would be covered, but most such transactions will be exempt because they will be under the price triggers. If a creditor has the audacity to offer home refinancing above 24% or a home-secured line of credit above 18%, it should comply with the MLA.

b. Financing to acquire personal property: Definition of "Purchase money security interest"

Congress intended the MLA to exclude legitimate, purchase money financing of personal property from the impact of this law. However, this exception should be drafted to preclude a historically common method of attempting to evade credit laws, the "sale / lease-back" or "sale / repurchase" agreement. In these transactions, a consumer ostensibly sells personal or real property that he or she already owned to a "buyer"/lender. The so-called "buyer"/lender then has the borrower sign a document that purports to either let the real owner "lease" it back, with an option to buy, or re-purchase in installments. The difference in the so-called "sale-price," and the amount

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[126] *See, e.g.* 15 U.S.C. § 1602(h), Reg. Z § 226.2(a)(12) (TIL); Reg. B, § 202.2(h) (ECOA).

[127] MLA § 987(i)(6).

[128] 15 U.S.C. § 1602(w); Reg. Z, §226.2(a)(24).

necessary for the consumer to regain ownership interest is disguised interest. [129] The item of property, of course, never leaves the possession of the borrower.

In order to forestall an easily foreseeable use of this exclusion to evade the law, particularly by car title loan lenders, rules should include a definition of '*purchase-money security interest"* which includes an element that the credit finance the <u>initial</u> acquisition of the personal property, and that it does not include transactions in which the service member or dependent had previously acquired some interest to the property, even if full legal title had not been acquired.[130]

The rules should also clarify that this exclusion applies only to secured credit made for the express purpose of financing the single, specific, identified item that will serve as collateral. This is necessary to ensure that credit cards that purport at the outset to take a security interest in every item purchased with it do not come within this exemption.

As adapted, such a definition might be as follow:

> *Definition of "purchase money security interest in personal property:"*
>
> "Purchase-money security interest" means a security interest in personal property taken in conjunction with a consumer credit transaction that finances the initial acquisition of a specific item of property named in the credit agreement. It does not include transactions in which the servicemember or dependent had previously acquired some interest to the property, even if full legal title had not been acquired. Nor does it include a security interest purportedly taken in any item purchased through a credit arrangement provided for general purposes and not for a specific item of property.

<u>H. Procedural Provisions</u>

<u>1. Arbitration</u>

The MLA prohibits mandatory arbitration clauses, MLA §987(e)(3), and provides that mandatory arbitration clauses as to "disputes involving the extension of consumer credit" are not enforceable against covered service members or their dependents. MLA §987(f)(4)

We propose that this provision be applied to all creditors. The effective date and phase-in period that we have proposed will ensure that these provisions do not pose compliance problems for lenders. Credit agreements prior to October 1, 2007 are not covered by the

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[129] For a description of cases involving the sale/re-purchase or sale/lease-back evasion in the personal property context, see National Consumer Law Center, *The Cost of Credit*, § 7.5.2.2 (3rd Ed. 2005).

[130] This is derived from TILA Reg. Z, § 226.2(a)(24) and OSC 226.2(a)(24)-5, describing purchase money financing in the real estate context.

MLA,[131] and we have proposed a one-year phase in period during which a creditor would not be in violation as long as it adapts its practices to the Act upon request of a Service member. Creditors have been on notice since September 2006 that mandatory arbitration clauses may not be imposed on consumer credit agreements with Service members. Thus, by the time the Act is fully operative, creditors will have had two years to amend their arbitration clauses to add a conspicuous disclaimer that the clause does not apply to active duty Service members or their dependents. Such a general provision would avoid the need to make individual determinations of eligibility at the time the credit is extended.

2. Waiver of Rights

Crucial to the effectiveness of MLA is the need to assure that MLA itself is not undermined – rendered useless, even -- by permitting creditors to require waiver of MLA rights. The rights granted under MLA were enacted, ultimately, for the good of all American citizens who are being served by the military as well as for the servicemen and women themselves, making it all the more important that they be respected in practice.

One witness at the Senate Banking Committee Hearing on Predatory Lending told of a serviceman required to waive his rights, and submit to arbitration under Delaware law. To proceed with his dispute against his lender, he would have had to travel to Delaware from his duty station in Florida (or, more preposterous yet, when at sea). Because he could not, he was unable to arbitrate his dispute.[132]

The Rule implementing this provision should be simple and unambiguous, such as the following: "A covered member may not waive or agree to forego rights or benefits under this Act. A waiver taken in violation of this provision is unenforceable."[133]

VI. PROHIBITION AGAINST STATES PERMITTING DIFFERENTIAL TREATMENT BETWEEN THEIR RESIDENTS AND NON-RESIDENT SERVICEMEMBERS STATIONED WITHIN THEIR STATE:

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[131] We have proposed that pre-existing credit cards become covered when their renewal period comes up and a new credit card is sent out. A modification to any arbitration provision can easily be provided at the same time.

[132] Testimony of Lynn Drysdale, Senate Predatory Lending Hearing, *supra* note 23.

[133] Some models provide exceptions where the waiver is taken in connection with a settlement of a bona fide dispute. For general models, see, e.g. UCCC, § 1-107 [1974]; EFTA, 15 U.S.C. § 1693*l*. We note that speculative concerns about the impact of the anti-waiver provisions on laws other than MLA have been raised to the Department, *e.g.* Comments of Bank Trade Association. While it is beyond the scope of these comments to address all potential concerns that have been raised, such as the ones concerning waiver, we believe that many are over stated, both practically and legally. We would be happy to offer supplemental comments responding to such concerns, if the Department would find it helpful.

MLA removes a significant hurdle that has prevented States from being able to adequately protect Service members stationed within their borders from predatory lenders for over a decade. It effectively reverses *Pioneer Military Lending, Inc. v. Manning,* 2 F.3d 280 (8th Cir. 1993), which enabled small loan lenders specializing in military lending to operate with virtually no regulatory oversight where it was needed – in most of the states where the bases are located. We are confident that States will welcome the opportunity finally to protect the service men and women living there.

In *Pioneer Military Lending,* the Eighth Circuit held that Missouri could not enforce its consumer lending law against a lender making loans from a Missouri location only to non-resident Service members stationed in Missouri.[134] This decision has been invoked to permit these specialty small loan lenders to target military personnel all over the country, while being licensed in only three states. Consequently, while banking regulators in Virginia or North Carolina can license, examine, regulate and oversee most small loan lenders operating in their states, they did not do so to small loan lenders specializing in military lending using this model.

The MLA effectively reverses *Manning*: it prohibits states from authorizing or permitting discriminatory pricing as to credit extended within their state to military non-residents stationed within their borders. [135] Under this provision, the states will now be able to regulate and oversee military lending within their borders.

We do not believe that this provision places any burden on creditors, except those for which *Manning* has been at the core of their business model. In the first instance, as described above, it requires that states "authorize" creditors to charge interest rates equally for military personnel and residents. To the extent that some states had authorized differential rates, it was only because of *Manning*, not because they thought it was sound policy.[136] If the creditor is not one subject to most states' laws on interest rates, as those entitled to preemption, then §987(2)(A) should not affect them. For example, credit cards now exporting their interest rates from their home state under federal law are not affected by what interest rates another state authorizes. Only if the creditors' home state law differentiates between non-resident military and residents would it affect them. Absent

[134] That is not to say that these lenders forego the opportunity to lend to Service members who happen to be residents of the states where they are stationed in order to take advantage of Manning. Recent reports from one of these lenders indicate that resident military borrowers are simply directed to a computer to obtain the loan through a different channel.

[135] MLA §987(d)(2). We note that the bank trade association comment suggests that this provision, mandating state to act, "may not survive constitutional challenge." p. 25. Most of the states we know chafed at feeling powerless to provide protection to non-resident military personnel based within their states because of *Manning*. The Florida Attorney General has been actively challenging this ruling. It is highly unlikely that they would now resent being freed of that case's restraint.

[136] *See, e.g.* Complaint against Omni Loan Company, Ltd., dba Omni Military Loans, California Department of Corporations, September 15, 2005, filed by Majors & Fox on behalf of Corporal Joshua W. Brack**.**

Manning, it is highly unlikely that any state would, or would want to make such a differentiation.

Similarly, the provision of subsection (B) only requires that states not allow creditors to discriminate as to other state consumer protections *on the basis of non-resident or military status*. This provision means that states will have to license and supervise lenders that concentrate on the military non-resident market just as they regulate other similiar lenders. Such protections would include state requirements to post fees, provide disclosures, or prohibit certain loan terms or collection tactics. No mainstream lenders, to our knowledge, differentially treat consumers on the basis of military status.

VIII. THE RULES SHOULD INCLUDE A GENERAL PROHIBITION AGAINST EVASION

As shown by the examples in the DOD predatory lending report, those in Section I of these comments, and the broader history of credit regulation, it is always the case that some providers will think of ways to create and exploit loopholes in the law. While our recommendations make an effort to foreclose *foreseeable* loopholes, it is a certainty that some imaginative subterfuges or ruses not on our radar screen will be attempted. [137]

This is certainly not an unprecedented situation. The Model Small Loan Act, the basis for most state small loan laws across the country, includes an "anti-evasion" provision.[138] Similarly, a provision in the Truth in Lending Act provides for regulation to prevent practices "designed to evade the provisions" of relevant sections.[139] We recommend that the Department include a provision similar to this in its rules.

CONCLUSION

The MLA represents an extraordinary vote of support for the men and women who are giving so much for their country – and ours. We know that the Department will do

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[137] In fact, a retired Marine Corp JAG officer whose service exposed him to the many ways such ruses were attempted by payday lenders urged this as one of the most important subjects to be addressed by the implementing regulations, along with adequate notice of MLA rights to servicemembers. Email from Michael Archer to CRL, January 18, 2007.

[138] The Virginia Small Loan Act, Va. Code § 6.1-251 provides one example, providing that the pivotal provision "shall apply to any person who seeks to evade its application by any device, subterfuge, or pretense whatsoever including, but not thereby limiting the generality of the foregoing: the loan, forbearance, use, or sale of credit (as guarantor, surety, endorser, comaker, or otherwise), money, goods, or things in action; the use of collateral or related sales or purchases of goods or services, or agreements to sell or purchase, whether real or pretended; receiving or charging compensation for goods or services, whether or not sold, delivered, or provided; and the real or pretended negotiation, arrangement, or procurement of a loan through any use or activity of a third person, whether real or fictitious."

[139] 15 U.S.C. § 1639(*l*)(2)(B).

everything within its power to assure that it is effective, and we will be happy to offer whatever assistance we can.

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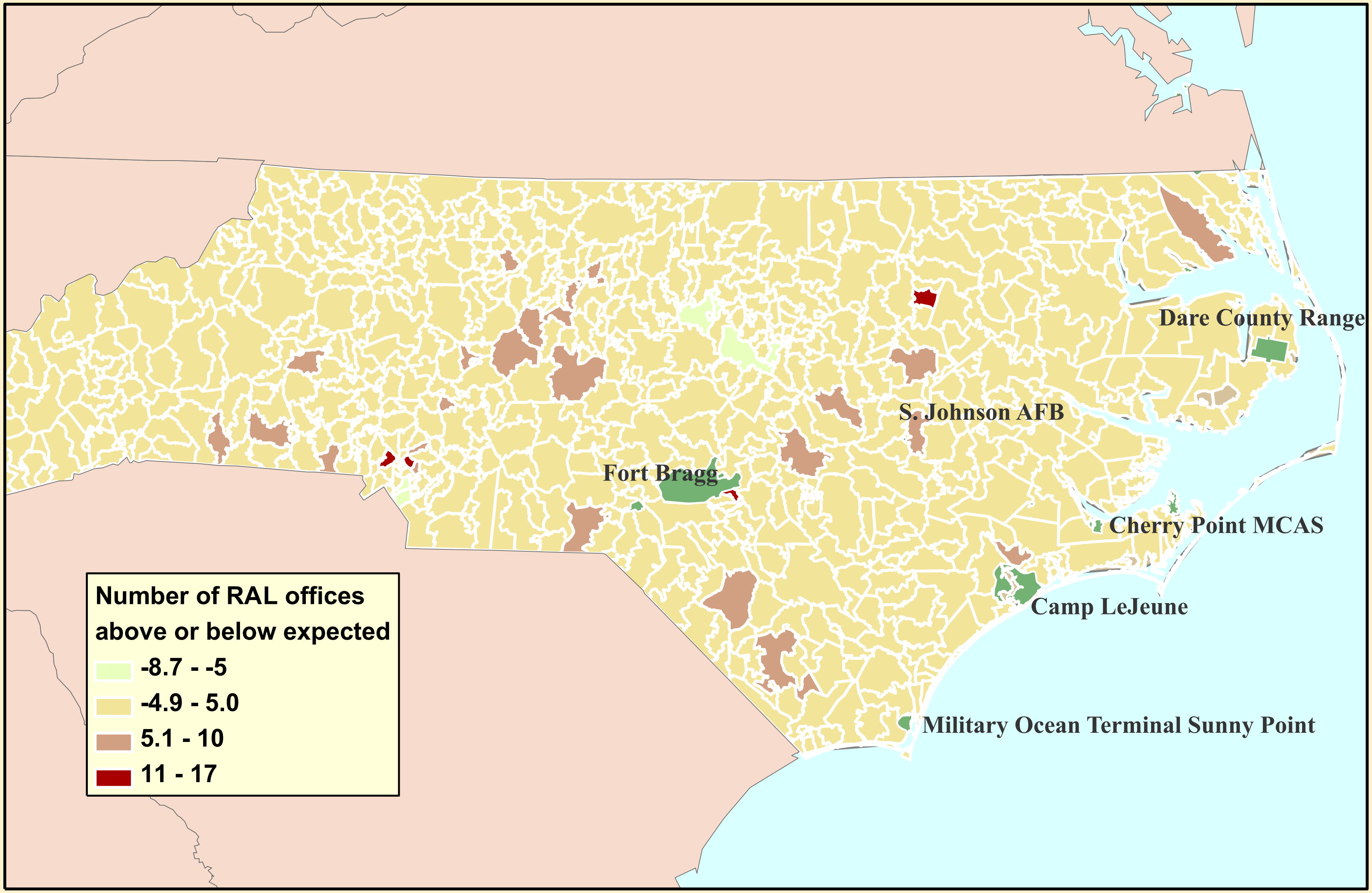
Appendices Follow:

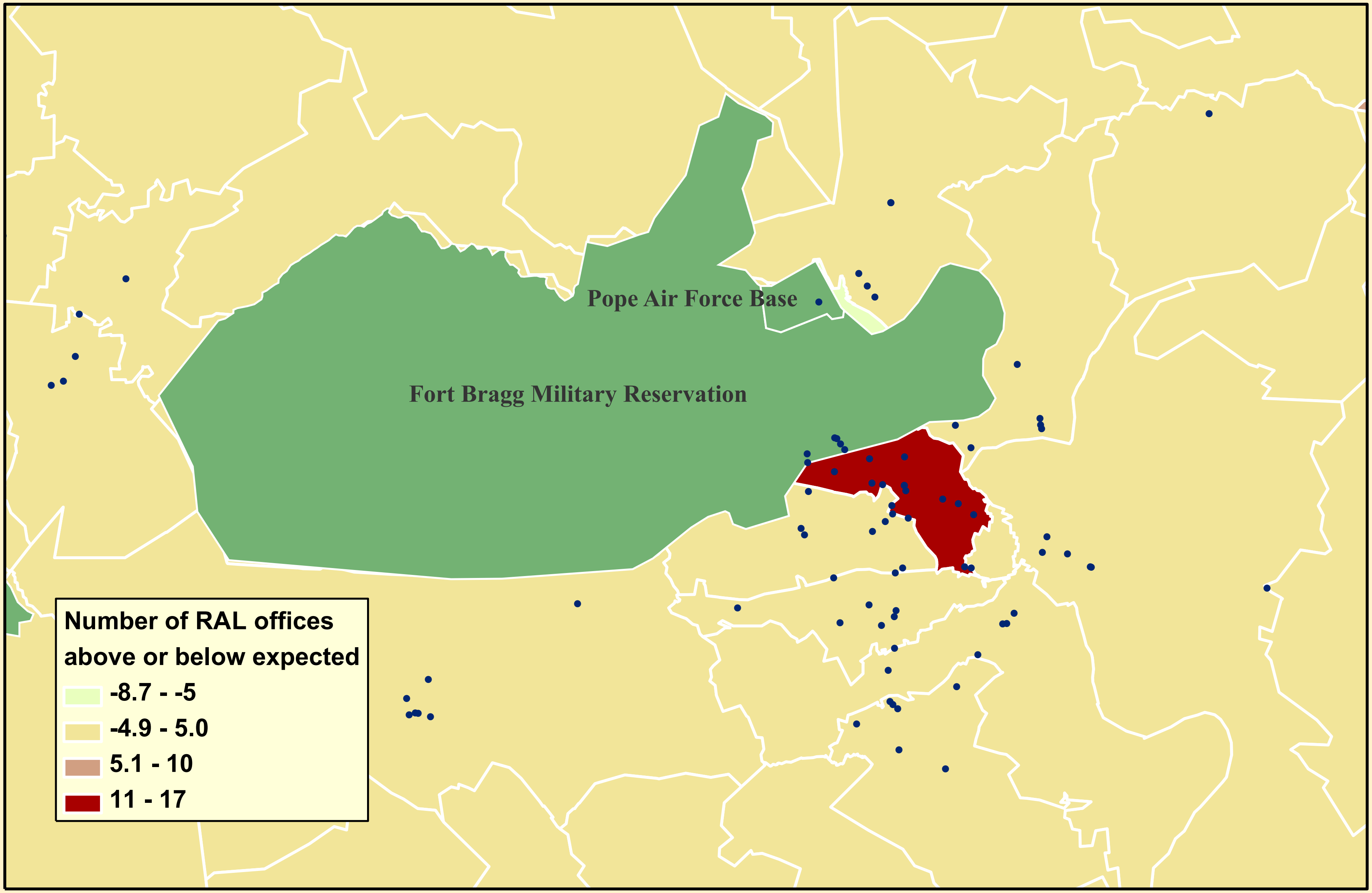


Refund Anticipation Loan Offices by ZIP Code
North Carolina

Steven M. Graves, PhD.
Department of Geography
California State University, Northridge

0 3 6 12 18 Miles

Source:
North Carolina Commissioner of Banks
Jan. 23, 2007

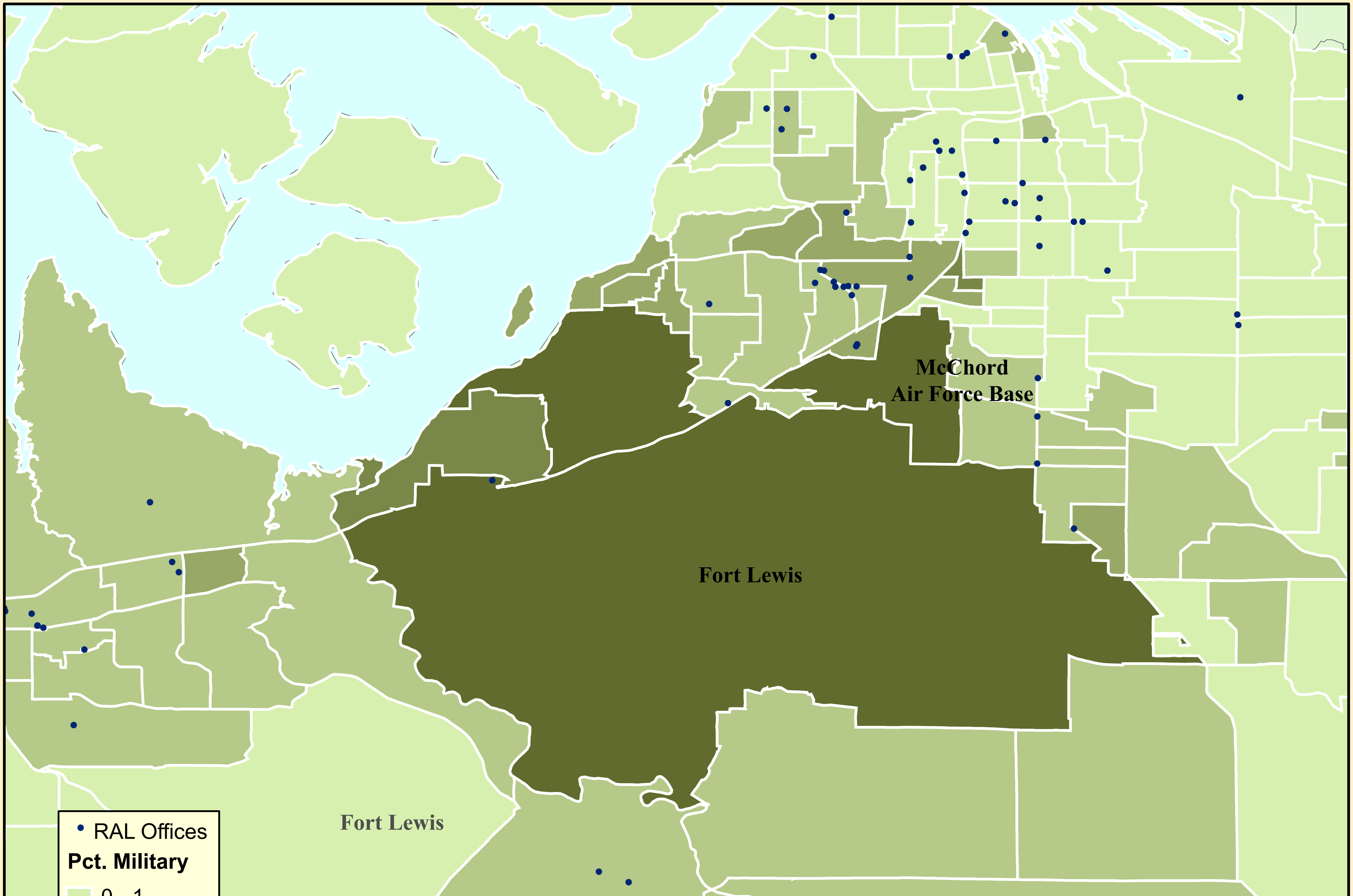


Refund Anticipation Loan Offices by ZIP Code
Fort Bragg/Pope AFB Region

Steven M. Graves, PhD.
Department of Geography
California State University, Northridge

0 0.3 0.6 1.2 1.8 Miles

Source:
North Carolina Commissioner of Banks
Jan. 23, 2007



Refund Anticipation Loan Offices
Fort Lewis and McChord AFB Region

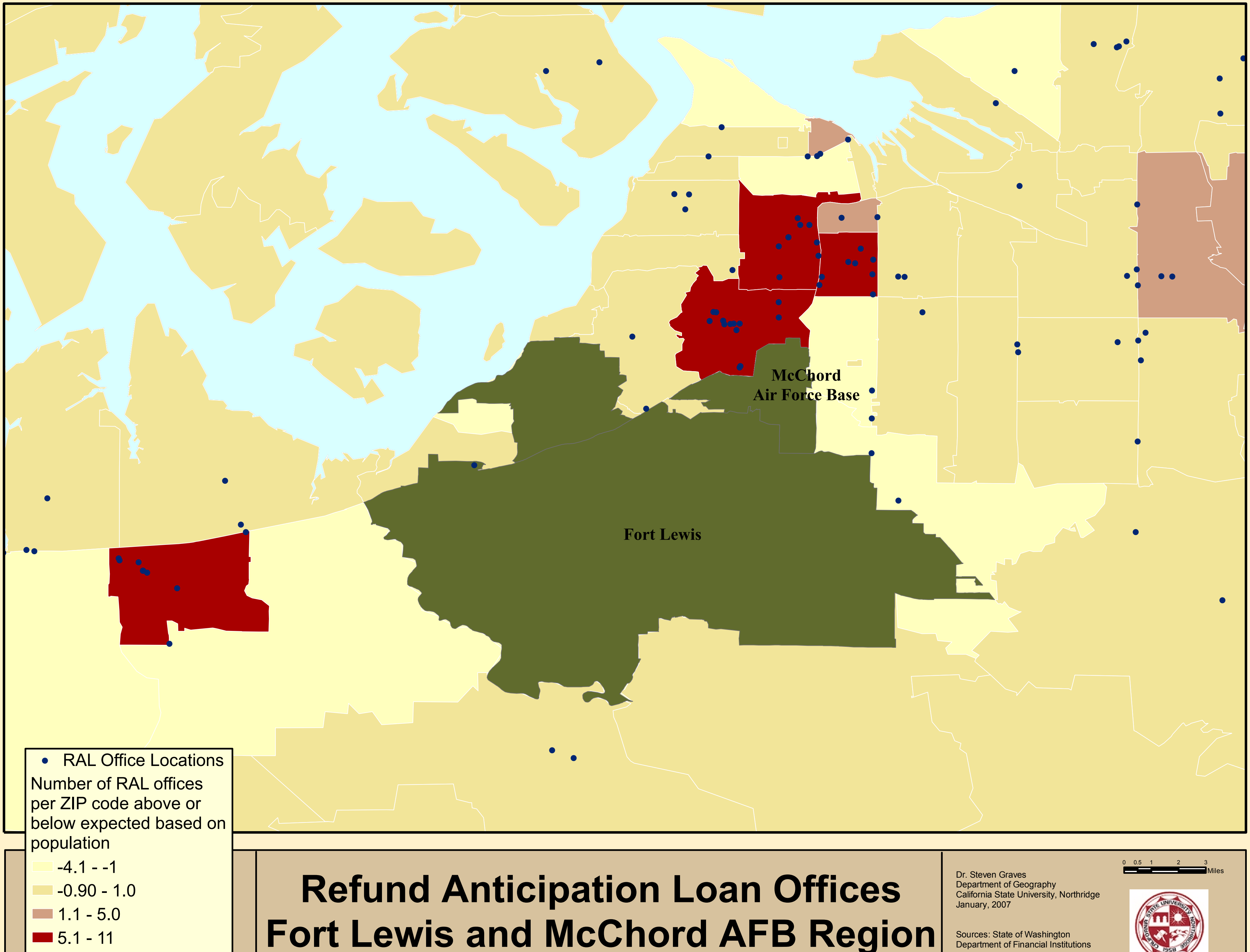
Dr. Steven Graves
Department of Geography
California State University, Northridge

January, 2007

Sources: State of Washington
Department of Financial Institutions

0 0.4 0.8 1.6 2.4 Miles

Refund Anticipation Loan Offices
Fort Lewis and McChord AFB Region



Dr. Steven Graves
Department of Geography
California State University, Northridge
January, 2007

Sources: State of Washington
Department of Financial Institutions

RATE, FEE AND OTHER COST INFORMATION

LGC11840

Annual Percentage Rate (APR) for purchases	A 0% fixed APR until the first day of the billing cycle that includes 04/01/2008. After that, 8.99% fixed.[a]
Other APRs	Balance Transfer APR: A 0% fixed APR until the first day of the billing cycle that includes 04/01/2008. After that, 8.99% fixed. Cash Advance APR: 24.24% variable Default APR: 32.24% variable. See explanation below.[b] Overdraft Advance APR: 13.99% fixed (not available in some states)
Variable rate information	The following APRs may vary monthly based on the Prime Rate:[c] Cash Advance APR: The Prime Rate plus 15.99%. Default APR: The Prime Rate plus up to 23.99%.[d]
Grace period for repayment of purchase balances	At least 20 days
Method of computing the balance for purchases	Two-cycle average daily balance method (including new purchases).
Annual fee	None
Minimum finance charge	$1.00
Transaction fee for balance transfers	No balance transfer fee on balance transfers made when you respond to this offer. Thereafter, 3% of the amount of each transaction, but not less than $5.00 nor more than $75.00.
Transaction fees for cash advances	3% of the amount of the transaction, but not less than $10.00.
Late Payment fee: $15.00 on balances up to, but not including, $100.00; $29.00 on balances of $100.00 up to, but not including, $250.00; and $39.00 on balances of $250.00 and over. **Over-the-Credit-Limit fee:** None for Signature; $39.00 for Platinum **International Transactions:** 3% of the U.S. dollar amount of the transaction, whether originally made in U.S. dollars or converted from a foreign currency.	

[a] **Rates, fees, and terms may change:** We reserve the right to change the account terms (including the APRs) at any time for any reason, in addition to APR increases that may occur for failure to comply with the terms of your account. For example, we may change the terms based on information in your credit report, such as the number of other credit card accounts you have and their balances. The APRs for this offer are not guaranteed; APRs may change to higher APRs, fixed APRs may change to variable APRs, or variable APRs may change to fixed APRs. Any changes will be in accordance with your account agreement.

[b] Your APRs may increase if you default under any Cardmember Agreement you have with us for any of the following reasons: We do not receive, for any payment that is owed on this Account or any other account or loan with us, at least the minimum payment due by the date and time due; you exceed your credit line on this Account, if applicable; you make a payment to us that is not honored by your bank; or, if at any time after your Account is closed, we demand immediate payment of your outstanding balance and we do not receive payment within the time we specify.

[c] The "Prime Rate" is the highest prime rate published in the Money Rates column of *The Wall Street Journal* two business days before the Closing Date on the statement for each billing period. Variable APRs are based on the 8.25% prime rate on 09/12/2006.

[d] We may consider the following factors to determine the default rate: the length of time your Account has been open; the existence, seriousness and timing of defaults; other indications of your Account usage and performance; and information about your other relationships with us, any of our related companies or from consumer credit reports.

CAPITAL ONE® IMPORTANT DISCLOSURES

Card Center, P.O. Box 30284, Salt Lake City, UT 84130-9842

ANNUAL PERCENTAGE RATE (APR) for purchases	**13.9%** (0.03808% daily periodic rate).
Other **APRs**	Balance transfer APR: Same as for purchases. Cash advance APR: 19.8% (0.05425% daily periodic rate).
Variable rate information*	Your purchase APR may vary monthly. The rate will be determined by adding 5.65% to the Prime rate. Your cash APR may vary monthly. The rate will be determined by adding 11.55% to the Prime rate. Rates in effect 11/01/06.
Grace period for repayment of the balance for purchases	25 days from the date of the periodic statement on new purchases (provided you have paid your previous balance in full by the due date).
Method of computing the balance for purchases	Average daily balance (including new purchases).
Minimum finance charge	For each Billing Period that your Account is subject to a finance charge, a minimum total **FINANCE CHARGE** of $0.50 will be imposed.
Membership fee	$0.
Miscellaneous fees	Cash advance fee: $0. Late payment fee: $0. Over-the-credit-limit fee: $0. Balance transfer fee: $0.

Returned payment fee: $0.
Foreign transaction fee: $0.

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Can You Increase My APRs? Your variable APRs can go up or down each month as the Prime rate goes up or down. We will never increase your APRs simply because you pay late or go over your credit limit. In the future, we may increase your APRs if market conditions change. If we increase your APRs for any reason other than an increase in the Prime rate, we will notify you in advance of your options in writing, including the right to opt out.

What About Any Other Terms Of My Account? We may change any other terms of your account, other than APRs, at any time. If we change any of these terms, we will notify you in advance of your options in writing, including the right to opt out of certain changes.

Do You Engage In Universal Default? We do not engage in a practice known as "universal default." Universal default permits a credit card company to increase your APRs simply because you fail to make a payment on a loan with another lender or your credit history contains other negative information.

* **How Do You Calculate My Variable Rate?** We calculate your variable rate by adding a percentage to the Prime rate published in the "Money Rates" section of *The Wall Street Journal* on the 25th day of each month. If the *Journal* is not published on that day, then see the immediately preceding edition. If Prime changes, your new rate will take effect on your next billing period.

What About Future Offers? We may offer you new products and services in the future, including new opportunities to transfer balances. These new products and services may have different APRs, fees and other terms, which we will explain in the offer.

How Do You Determine My Credit Line? We determine your credit line based on your credit history and information you provide on your Application. If your Application is approved, you will receive a credit line between $5,000 and $30,000.

How Do You Apply My Payment? We will apply your payment to pay off lower-rate balances before paying off higher-rate balances.

How Do You Calculate My Minimum Payment? Your minimum payment will be the greater of 3% of your outstanding balance or $10. If your balance is less than $10, your minimum payment will equal your balance. Please remember that APR increases and fees may increase your minimum payment.

SUMMARY OF PRICE-TRIGGER "SAFETY-ZONE"

	"SAFETY ZONE" Lending at or below: a) 18% periodic rate + fees within limits prescribed[i], or b) 24% for "all-in-the-rate/ no fee" products[ii]	**FULLY SUBJECT TO MLA:** Lending between the "safety zone" and 36%	**"NO-GO ZONE"** **No lending over 36%**
MLA provisions applicable	a.) No mandatory allotments b) Single payment credit must comply with EFTA; b) no check-holding c) no mandatory arbitration d) No waiver of MLA provisions	All	No lending over 36%. The "safety-zone" limits could result in occasional, incidental forays over the 36% limits.
MLA provisions not applicable	a) Incidental fees above 36% permitted if within tolerances or if reduced upon request. b) extra MLA or oral disclosures c) limitations on refinancing d) unreasonable notice provision e) prohibition against title as security f) no prepayment penalty	No exceptions	

[i] Annual or other required fees must not exceed $50/year, or $100 for credit of $5,000 or more. All other fees cannot exceed the greater of $40/month (only if there is late payment or other default) or 3% of the monthly balance.

[ii] For closed end credit only, an annual fee of $50 and late fees of the greater of $20/month or 5% of the late balance would be permitted above the 24% interest cap.

Why Our Credit Union Has Wrestled With Realities Of 'Courtesy Pay'

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Opinion
By Mary Cunningham
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HOUSTON -- As credit unions seek new and innovative ways to serve members, we often look to other players in the financial services arena for ideas. One such service that banks have provided throughout the years for their prime customers is called Privilege Pay.

This product is also known as courtesy pay or overdraft privilege and is typically implemented as a non-contractual courtesy pay product meant to step in and pay rather than return non-sufficient funds transactions on checking accounts.

Most credit unions that offer a privilege pay product charge fees similar to their fee for returning items. Idealistically, this product is offered to save members the embarrassment of a returned check as well as fees generated by the merchant to whom the check was written.

The program also carries the potential for significant revenue generation for the credit union. At first glance, it seems like a sure winner for both the member and the credit union.

Our credit union implemented a privilege pay product a few months ago and my board, and I asked for a report after the first 90 days.

We asked to see who was using the product, how many times per month, average amount of draft that triggers the product's use, average age of user, and whether or not they were chronic overdrafters before the product was introduced.

The results were alarming.

Instead of Privilege Pay being used as we had intended, a number of our members chose to utilize the product more as a non-qualifying line of credit.

Our research revealed that users are often negative for two or more deposits to their account before it is brought to a positive balance again. It was also learned that younger, possibly less-established members were frequent users. In fact, nearly

33% of Privilege Pay users were overdrawing more than five times per month.

And we also learned that if these same members were applying for an unsecured loan of that same amount, they probably wouldn't qualify.

Fees Add Up Quickly

For a member who lives payday to payday, these fees add up quickly. A member who chronically abuses his checking account is likely to abuse this new product, as well. Once they've maxed out at a negative $1,000, which is our limit, the next paycheck is automatically spent once deposited, thereby creating a downward spiral for the member. In this case, we are no longer offering value and a better deal to the member-we're adding to his problems.

Our senior management team and I have had lively discussions over whether or not the credit union is at fault here. Are we our brothers' keeper, they ask? Any product the credit union offers is subject to abuse if a member is irresponsible. Why is it our fault? Members know if they're overspending-writing checks and trying to play the float (which very soon will be a thing of the past). Why shouldn't we provide the service of paying that check rather than returning it? The fee is the same either way. Aren't we providing better service by paying the check and saving the member from embarrassment and additional fees on the other end? My CFO also likes the income. Enough said.

We also had several counter-arguments. Even though the product, in theory, is a great service to offer to members, it also is a product that aids and abets the weak, irresponsible members. The fact is, a fourth of our users of this product are under the age of 25.

My guess is that many of those young people are sailors and soldiers that are in our military field of membership. Most are on modest budgets and have quickly begun to use this product abusively.

Once they're in the negative, each subsequent day's clearings cause additional fees. These fees are the norm for NSF transactions. But if translated to an APR, would put us right up there with every payday loan company I've been badmouthing through the years.

As the negative balance grows, this causes a dependency on the product, similar to the "rolling" of a payday loan. While technically this is not a loan, the cost to the member is the same, whether you call it a privilege pay fee or a finance charge. Either name means money out of the member's pocket.

We can argue the fine points all day long, but I always cut back to the member and whether or not we're helping or hindering them. I believe we have a social responsibility to be the consumer's advocate.

We should always offer the better deal. I've believed that for 30 years

To be fair, however, I should also confess that we have had members occasionally call and thank us for having this service. It can work exactly the way it was meant to work.

Therefore, unlike my friend from North Carolina, I would rather not throw the baby out with the bath water. Rather than do away with the Privilege Pay product, I asked my staff for some recommendations to control the losses and abuse. These are the modifications to Privilege Pay that we're making and I would suggest that you might want to consider.

* We decided to continue the practice of liberally refunding fees while educating members about the service. We also offered an opt-out for members who felt they didn't need it or might be tempted to use it too much. The fee income for this product has been substantial so refunding fees is an easy fix and a practice that's been well received by members. Informed and educated members will know how to use the service properly rather than abusively.

* Part of that education consists of explaining to members how the clearing process works: Share transfer first, Line of Credit overdraft loan next, and Privilege Pay last. And we push the LOC loan instead of marketing the Privilege Pay product. We also assess only one fee per day's clearings, per type of clearing. In other words, no matter how many checks are presented for payment in a given day, we only charge one fee. And no matter how many debit items are presented, we only charge one fee.

* We suspend the product for members who don't cure the negative balance within 45 days. This controls further abuse and fees being assessed, which causes the downward spiral for the member.

* Once a member has overdrawn his account and used the Privilege Pay product, our notice automatically includes contact information about Balance, which is a toll-free financial counseling service that we provide at no charge for all members.

* We lowered our negative balance limit from $1000 to $750, since the average amount of an item that triggers Privilege Pay is less than $100.

* We reduced our charge for NSFs as well as Privilege Pay fees for all checking accounts.

* We are researching the ability to warn members at the ATM if they are about to trigger a Privilege Pay fee. We also made sure that the negative balance allowed does not show up as available funds at the ATM.

* We changed our screening practices to be sure that accounts had been opened for at least 90 days and were making deposits equal to or greater than the Privilege Pay limit of $750.

* We are frequently publishing Q&A segments on our website and in our newsletters to address Privilege Pay questions.

Conduct Your Own Analysis

If I were to summarize the lessons we've learned along the way, I would suggest that you might want to conduct your own analysis of the product if you haven't done that lately. You might be surprised at who the users are and how they might be hurt by it.

Controlling this product on the back end is essential if it's truly going to be perceived as a service and not a credit union payday loan clone.

It has often been said that perception is reality. A lot of people are watching our industry these days, because we've become a competitive force to be reckoned with. That's a good thing. But if we put out products that are beneficial to some and harmful to many, the credit union industry will ultimately pay the price-whether it was the poor irresponsible consumer's fault or not.

Mary Cunningham is president/CEO of USA Federal Credit Union, San Diego, Calif.