



United States Senate
Committee on Banking, Housing, and Urban Affairs

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Hearing On:

Empowering and Protecting Servicemembers, Veterans and their
Families in the Consumer Financial Marketplace: A Status Update

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Tuesday, June 26, 2012

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Statement for the Record

Submitted By
The American Financial Services Association

Statement of Interest

The American Financial Services Association (“AFSA”) is pleased to file these comments to the Committee as a status update on “empowering and protecting servicemembers, veterans and their families in the consumer financial marketplace.”

AFSA is the national trade association for the consumer credit industry, protecting access to credit and consumer choice. The association encourages and maintains ethical business practices and supports financial education for consumers of all ages. AFSA has provided services to its members for over 95 years. AFSA’s 350 member companies include consumer and commercial finance companies, vehicle finance companies including the captives, credit card issuers, mortgage lenders, industrial banks, and other financial service firms that lend to consumers and small businesses.

AFSA member companies offer many types of consumer credit products, including credit cards, vehicle loans and leases, personal installment loans and mortgages (together hereinafter referred to as “consumer installment credit”). AFSA members are responsible for providing roughly 80 percent of the nation’s vehicle financing. In general, finance companies represent one of every five dollars of consumer credit outstanding.

AFSA is very appreciative of the Committee’s desire to examine the financial issues and concerns faced by military servicemembers, veterans and their families (hereinafter referred to collectively as “servicemembers and their families”). We are sensitive to the hardship that is placed on servicemembers and their families with repeated deployments, especially for dual career spouses, and the financial difficulties created by frequent moves.

AFSA works continuously with regulators at the state and federal levels to ensure that servicemembers and their families are protected against unscrupulous lending practices.

AFSA Members Strive to Understand and Meet the Needs of Servicemembers and their Families

AFSA members also serve servicemembers and their families by offering beneficial forms of consumer installment credit, which:

- Have existed for over a hundred years;
- Are based on the borrower’s ability to pay;
- Are paid in equal monthly installments of principal and interest like traditional mortgages, which give borrowers a roadmap out of debt; and
- Are fully regulated by federal and state laws, and the federal and state agencies empowered to enforce those laws.

Additionally, AFSA members report to the credit bureaus to allow responsible borrowers to improve their credit score, and provide a number of financial literacy programs including the AFSA Educational Foundation’s (“AFSAEF”) MoneySKILL program.

AFSA members endeavor to provide the best customer service to all of their customers, including servicemembers and their families. We always attempt to assist all of our customers, servicemembers and civilians alike, in times of hardship and inconvenience to work out financial solutions to their problems. We realize that condoning harmful lending practices to servicemembers and their families endangers the good actors in the lending industry. We strive to comply with all regulations and statutes, including the Servicemembers Civil Relief Act.

It is imperative to ensure that servicemembers and their families have access to a full range of legitimate and fair credit opportunities. Burdensome restrictions on legitimate practices serve to limit the range of financial products that are available to servicemembers and their families. This reduces competition and moves counter to the objective of empowering servicemembers and their families.

The key to protecting servicemembers and their families is transparency – simple, clear, plain-language disclosures and terms that are fair, without tricks or traps. Finance companies use plain-language disclosures for servicemembers and civilian borrowers alike. Along these lines, AFSA members’ practices include: (1) letting the borrower see the cost of the loan in simple terms; and (2) if other products are offered by the lender, such as credit insurance, providing a clear statement of the cost and the optional nature of these products, and obtaining affirmative consent if the consumer chooses to purchase such a product.

We want servicemembers and their families to continue to have access to affordable, safe, and disciplined consumer installment credit contracts. AFSA is willing, even eager, to meet with the entire military chain of command to inform them about our members’ financial products and seek their advice on additional guidelines that may be needed to encourage even better lending practices. We will work with the Department of Defense (“DOD”) and the military branches to support efforts on financial education.

AFSA is eager to work with the Consumer Financial Protection Bureau’s (“CFPB”) Office of Servicemember Affairs to continue to encourage standards of ethics to ensure servicemembers and their families are not targeted by unfair lending practices. Leveraging our industry’s resources can increase the ability of the CFPB to ensure that servicemembers and their families are treated fairly.

Occasionally, concerns about potentially abusive practices are brought to the attention of AFSA and its members. Whether these concerns relate to civilian or military customers, we take such matters very seriously. AFSA members strive to respond promptly to individual consumer complaints as soon as they are made aware of them. However, oftentimes generalized observations are made about lending practices based upon anecdotal examples that do not represent industry norms. Furthermore, observations relating to certain types of short-term credit products that AFSA members do not offer have sometimes been applied to traditional installment loans, which, as discussed below, carry significantly different features and are structured under a more disciplined debt reduction schedule than the newer hyper-lending products – which have been where problems have arisen for servicemembers.

In general, the rare cases of alleged illegal behavior could, and should, be addressed under existing consumer protection statutes and regulations, or the criminal code, at the state and federal levels. Where there is empirical data to support a pattern or practice of such behavior, AFSA and its members are extremely interested to know about it so that we may take steps proactively to address shortcomings in compliance.

Defense Department Regulation on Consumer Credit should be Retained

In 2006, Congress enacted provisions in Section 670 of the John Warner National Defense Authorization Act for Fiscal Year 2007 (commonly known as the “Military Lending Act” or “MLA”) to cap the annual percentage rate (“APR”) at 36 percent and impose other limitations on certain consumer loans to servicemembers and their dependents, with the objective of protecting military households from becoming trapped in a cycle of debt.¹

Regulations pursuant to the MLA promulgated by the DOD in 2007 (“Final Rule”) contain limitations on and requirements for certain types of consumer credit extended to covered borrowers – which include active-duty service members and their spouses, children and other dependents. The Final Rule applies to payday loans, vehicle title loans and tax refund anticipation loans.²

As Col. Paul Kantwill, Director of Legal Policy in the Office of the Under Secretary of Defense (Personnel & Readiness), notes in his prepared testimony today:³

With the assistance of the seven Federal financial regulatory agencies, DoD was able to draft and release a regulation within the prescribed time limitation seen as acceptable and workable by both the consumer advocates and the mainstream financial industry providers... Annually, the Department has sent a representative to the national conference of state regulators to ensure there are no difficulties in obtaining compliance from the covered creditors. Each year the regulators have reported that their examinations have found compliance with the Rule and no need for enforcement action.

Moreover, in response to a question posed by Sen. Vitter at his confirmation hearing about the Department’s intension to expand the regulation, Defense Secretary Panetta replied:⁴

No, the DoD has not changed its policy and does not intend at this time to include other lenders within the coverage of the regulation. The Department proposes to

¹ 10 USC 987. Terms of Consumer Credit Extended to Members and Dependents: Limitations. Public Law 109-364. October 17, 2006.

² 32 CFR 232. Limitations on Terms of Consumer Credit Extended to Service Members and Dependents; Final Rule. August 31, 2007.

³ Kantwill, Col. Paul. Testimony before U.S. Senate Committee on Banking, Housing, and Urban Affairs, Hearing on “Empowering and Protecting Servicemembers, Veterans and their Families in the Consumer Financial Marketplace.” June 26, 2012.

⁴ Panetta, Hon. Leon E. Response to Questions for the Record submitted by Sen. David Vitter, Hearing before the U.S. Senate Committee on Armed Services. June 9, 2011.

help ensure that Service members and their families receive fair protections by working with federal and state governments on existing and proposed policies impacting all consumers. The goal is to try to eliminate the need to identify Service members and their families for protections, which may create unintentional barriers to credit.

AFSA notes that in the Final Rule, the DOD recognized the problems servicemembers and their families were facing from various new forms of harmful consumer credit and proposed regulations to protect them. The DOD saw the importance of implementing strong protections without unduly restricting access to valuable and beneficial credit products for servicemembers and their dependents. AFSA agrees with the DOD that these newer forms of credit can be harmful to servicemembers, as detailed in the Department's 2006 report to Congress that motivated enactment of the MLA.⁵ Payday loans, in particular, are a relatively new type of consumer financing, having originated and evolved primarily in recent years. By contrast, the consumer finance industry has been providing military servicemembers with fair and reasonably-priced access to credit in a safe and responsible manner for over a century.

As Holly Petraeus, Assistant Director of the CFPB's Office of Servicemember Affairs, made clear in her November 3, 2011, testimony before this Committee, it is imperative that any laws or regulations that policymakers may propose in the future do not result in unintended consequences.⁶ The inadvertent risk of restricting the availability of legitimate and appropriate credit products to deserving servicemembers and their families would be far more devastating than most people recognize. It was this concern that led the DOD to limit the scope of the Final Rule to payday loans, vehicle title loans and tax refund anticipation loans.

DOD Rule Sufficiently Protects Servicemembers and their Families

At the same November 3 hearing, Admiral Steve Abbot, USN (Ret.), the President of the Navy-Marine Corps Relief Society, told this committee that "the Military Lending Act (MLA), which became effective in October 2007, has dramatically curtailed payday loans to active duty service members." This would seem to suggest that existing statute is serving its purpose.⁷

Further, in responding to a question by a member of this Committee, Mrs. Petraeus expressed concerns about the unintended consequences of extending the existing 36 percent APR rate cap beyond the products covered by the Final Rule. AFSA echoes those concerns and urges policymakers to consider the consequences of regulating useful, desirable forms of consumer credit out of existence for the military community.

⁵ Department of Defense Report on Predatory Lending Practices Directed at Members of the Armed Forces and their Dependents. August 9, 2006.

⁶ Petraeus, Hollister K. Testimony before U.S. Senate Committee on Banking, Housing, and Urban Affairs, Hearing on "Empowering and Protecting Servicemembers, Veterans and their Families in the Consumer Financial Marketplace." November 3, 2011.

⁷ Abbot, Admiral Steve, USN (Ret). Testimony before U.S. Senate Committee on Banking, Housing, and Urban Affairs, Hearing on "Empowering and Protecting Servicemembers, Veterans and their Families in the Consumer Financial Marketplace." November 3, 2011.

In its only report following the issuance of the Final Rule, the DOD itself said that the rule is achieving its intended purpose.⁸

Congress should Tread Carefully in Amending the MLA

Notwithstanding this evidence that the DOD's existing regulation is working effectively, Congress is currently considering amendments to the MLA as provisions of the National Defense Authorization Act for Fiscal Year 2013.

Section 661 of H.R. 4310, as passed by the House, would redefine the term "dependent" to expand the scope of covered borrowers to mirror the definition used to establish eligibility for military medical care in section 1072 of Title 10, United States Code.

Sections 651-654 of S. 3254, taken together, as passed by the Senate Armed Services Committee, would amend the MLA to outlaw certain extensions of credit altogether to servicemembers and dependents, and would cap the rates that may be charged on other forms of credit.

It appears that these provisions may be based, at least in part, upon a recent review of the MLA published by the Consumer Federation of America ("CFA"). Col. Kantwill refers to this report in his testimony, stating:

The Department is currently reviewing the CFA recommendations and, after completion of an internal survey, which will measure the prevalence and impacts of concerns with financial products, will review options for appropriate action.

AFSA would like to note for the committee and the DOD that the report in question does not provide any empirical evidence to support the findings upon which its recommendations are based. In fact, the author reveals the following:⁹

CFA asked the Better Business Bureau Military Line staff if the online installment lenders in the survey had triggered complaints. The BBB searched their database of over 40,000 complaints received over the first three quarters of 2011 involving a wide variety of products and services and found 37 complaints filed against the online military installment lenders listed in the CFA survey.

By this analysis, the CFA is making recommendations for changes to the MLA based upon complaints that amount to less than one tenth of one percent of the complaints reviewed – in spite of the position of the DOD that the current regulations have effectively addressed the problems identified prior to enactment of the MLA.

⁸ Department of Defense Report on Implementation of Limitations on Terms of Consumer Credit Extended to Service Members and Dependents. July 22, 2008.

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

AFSA does not believe that further limiting access to credit for military households is wise or necessary at this juncture. The proposed amendments could materially impact servicemembers and their families such that undue financial stress could be created where none currently exists. These provisions could foreclose upon the ability of servicemembers and their families to obtain traditional credit products, forcing them into the hands of non-traditional lenders – some of which are domiciled overseas and operate on the Internet, outside the reach of U.S. regulators – or even worse, underground and unregulated lenders (commonly known as “loan sharks”). Such a misstep would be detrimental to military personnel readiness, something that should be avoided at all costs.

The DOD understands the importance of maintaining access to beneficial credit as a compelling need for its personnel. In its Final Rule, the DOD notes “the potential for unintended consequences that could adversely affect credit availability if it were to adopt a broadly applicable regulation.”¹⁰ The DOD looked to identify the key problems and to use the authority granted by the MLA to define “consumer credit” in a way that achieves the intent of Congress while preserving the availability of beneficial forms of credit to military families.

Traditional Installment Loans

Installment Loans are Beneficial to Servicemembers and their Families

Traditional installment lending provides access to reasonably-priced credit because lenders work with borrowers to determine that they have the ability to repay the loan. It is the safest form of small-dollar lending. Installment loans utilize amortization as a means of protecting borrowers from an endless cycle of debt. The installment credit products offered by the member companies of AFSA are not the problem – in fact they are often the best solution to the financial needs of servicemembers and their families. Installment loans are clearly, and have long been, a beneficial and useful service for servicemembers and their families.

The beneficial features of installment loans were also recognized by the DOD in the conclusion of its report to Congress on the effectiveness of the regulations implementing the MLA: “Isolating detrimental credit products without impeding the availability of favorable installment loans was of central concern in developing the regulation. Consequently, installment loans that do not fit the definition of ‘consumer credit’ in Section 232.3(b)...are not covered by the regulation.”¹¹

Conventional commercial banks, credit unions, and military relief societies are not in a position to provide adequate credit to servicemembers and their families due to the costs of underwriting and servicing small-dollar loans. Banks and credit unions have simply been unable to duplicate the traditional installment loan model in an economically unsuccessful way. The services’ military aid societies have neither the mission nor the financial capacity to meet the financing

¹⁰ 32 *CFR* 232. Limitations on Terms of Consumer Credit Extended to Service Members and Dependents; Final Rule. August 31, 2007.

¹¹ Department of Defense Report on Implementation of Limitations on Terms of Consumer Credit Extended to Service Members and Dependents. July 22, 2008.

needs of a large and diverse military population without a significant infusion of charitable donations or taxpayer subsidies. While the aid societies do provide critical assistance to servicemembers in challenging and difficult circumstances, often with nowhere else to turn, they simply are not designed to fulfill the role of serving normal small-dollar credit needs in the general marketplace. In fact, AFSA members report that many of their clients come to them specifically because their credit needs fall outside of the limited scope of the general lending guidelines of the military aid societies, which are designed to assist in emergencies and special circumstances.

Installment Loans Help Meet the Unique Needs of Servicemembers and their Families

Small-dollar, traditional installment loans help meet the needs of servicemembers and their families. Some AFSA members lend money to servicemembers as they are getting ready to deploy. Servicemembers often must borrow in order to procure additional supplies they will need in the combat environment, such as body armor. They also borrow before they deploy in order to get their households in order and to have an amount of emergency cash on hand to be available to their spouses and families. An increase in debt consolidation loans is seen at this time as well.

Permanent change-of-station moves, overseas assignments, and relocations are some of the more prevalent reasons why servicemembers borrow. Often servicemembers say that there is never enough money available to move and that they need additional funds to supplement what the military provides. Physical moving costs, security deposits and new appliances are all expenses that are incurred during a move. AFSA members making these loans recognize this “purpose of loan” as bona fide and as such, are willing to extend small-dollar credit to meet these needs.

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AFSA believes that it is important to ensure that access to beneficial forms of credit is preserved for members of the military and their families while, at the same time, ensuring that sensible consumer protections are maintained. AFSA appreciates that the Office of Servicemember Affairs is taking the time to collect information regarding consumer finance products and services offered to servicemembers and their families. AFSA looks forward to continuing to work with Congress and federal regulators as new laws and regulations are contemplated.

Please feel free to contact AFSA Executive Vice President Bill Himpler with any questions at 202-296-5544, ext. 616, or bhimpler@afsamail.org.