



United States Senate  
Committee on Commerce, Science, and Transportation

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Hearing On:

Soldiers as Consumers: Predatory and Unfair Business Practices  
Harming the Military Community

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Wednesday, November 20, 2013

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Statement for the Record

By The

**American Financial Services Association**

## **Statement of Interest**

The American Financial Services Association (“AFSA”) is pleased to file these comments to the Senate Commerce Committee on the occasion of its hearing on “Soldiers as Consumers: Predatory and Unfair Business Practices Harming the Military Community.”

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 and their families. We are sensitive to the hardship that is placed on military 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 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 Military Lending Act and 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 ancillary 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 them.

We want servicemembers and their families to continue to have access to affordable, safe and disciplined consumer installment credit. AFSA is willing 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 are also eager to work with the Department of Defense (“DOD”) and the military branches to support efforts on financial education.

AFSA hopes to be a resource to the Consumer Financial Protection Bureau’s (“CFPB”) Office of Servicemember Affairs in order to encourage standards of ethics and ensure that 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 consumers, we take such matters very seriously. AFSA members strive to respond promptly to individual customer 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. Traditional installment loans are underwritten strictly based upon the borrower’s ability to repay and they are structured under a more disciplined debt reduction schedule than the newer hyper-lending products – which

have been where problems have arisen for servicemembers who become trapped in a cycle of debt.

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 with the law.

## **Defense Department Regulation Protects Military Community from Risky Forms of Credit**

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.<sup>1</sup>

Implementing regulations 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 servicemembers and their spouses, children and other dependents. The Final Rule applies to payday loans, vehicle title loans and tax refund anticipation loans.<sup>2</sup>

### ***DOD Rule Sufficiently Protects Servicemembers and their Families***

In its only report following the issuance of the Final Rule, the DOD itself said that the rule is achieving its intended purpose.<sup>3</sup>

Assessing the effectiveness of the Final Rule, Col. Paul Kantwill, Director of Legal Policy in the Office of the Under Secretary of Defense (Personnel & Readiness), stated the following in his June 2012 testimony to the Senate Banking Committee:<sup>4</sup>

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

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

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

<sup>3</sup> Department of Defense Report on Implementation of Limitations on Terms of Consumer Credit Extended to Service Members and Dependents. July 22, 2008.

<sup>4</sup> 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.

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.

At a November 2011 hearing, Admiral Steve Abbot, USN (Ret.), the President of the Navy-Marine Corps Relief Society, told the Banking 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.<sup>5</sup>

### ***Officials Warn of Unintended Consequences of Restricting Access to Credit***

As Holly Petraeus, Assistant Director of the CFPB’s Office of Servicemember Affairs, stated in her testimony at the very same hearing, it is imperative that any laws or regulations that policymakers may propose in the future do not result in unintended consequences.<sup>6</sup> 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 prompted the DOD to limit the scope of the Final Rule to payday loans, vehicle title loans and tax refund anticipation loans.

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

Finally, Defense Secretary Leon Panetta expressed satisfaction with current policy when he responded to a question posed by Sen. Vitter upon his June 2011 confirmation hearing about whether the Department saw a need to expand the scope of the regulation:<sup>7</sup>

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 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.

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<sup>5</sup> 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.

<sup>6</sup> 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.

<sup>7</sup> 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.

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 traditional credit products for servicemembers and their dependents. AFSA agrees with the DOD that some 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.<sup>8</sup> Payday loans, in particular, are a relatively new type of consumer credit, 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 in the form of traditional installment loans.

### ***Policymakers should Tread Carefully before Restricting Credit to the Military***

AFSA does not believe that further limiting access to credit for military households is wise or necessary at this juncture. To do so could create undue financial stress where none currently exists. Foreclosing upon the ability of servicemembers and their families to obtain traditional credit products could force 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.”<sup>9</sup> 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.

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<sup>8</sup> Department of Defense Report on Predatory Lending Practices Directed at Members of the Armed Forces and their Dependents. August 9, 2006.

<sup>9</sup> 32 *CFR* 232. Limitations on Terms of Consumer Credit Extended to Service Members and Dependents; Final Rule. August 31, 2007.

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.”<sup>10</sup>

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 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 community while, at the same time, ensuring that sensible consumer protections are maintained. We appreciate the Commerce Committee holding this hearing on

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<sup>10</sup> Department of Defense Report on Implementation of Limitations on Terms of Consumer Credit Extended to Service Members and Dependents. July 22, 2008.

aggressive business practices that some soldiers and their families face, as well as ways to protect servicemembers from abusive behavior. AFSA looks forward to continuing to work with Congress and federal regulators to improve the quality of life for military families.

Please feel free to contact AFSA Executive Vice President Bill Himpler with any questions at 202-466-8616 or [bhimpler@afsamail.org](mailto:bhimpler@afsamail.org).