



Office of the Chairman

December 16, 2014

Mr. Aaron Siegel  
Alternate OSD Federal Register Liaison Officer  
Department of Defense  
Federal Docket Management System Office  
4800 Mark Center Drive, 2<sup>nd</sup> Floor, East Tower  
Suite 02G09  
Alexandria, VA 22350-3100

Dear Mr. Siegel:

RE: Docket DOD-2013-OS-0133, RIN 0790-AJ10,  
Limitations on Terms of Consumer Credit  
Extended to Service Members and Dependents

I thank you for the opportunity to comment on the important proposed rule the Department of Defense (Department) has issued to amend regulations under the Military Lending Act (MLA).<sup>1</sup> The proposed rule (Proposed Rule) is intended to enhance protections available to Service members and their dependents when they receive consumer credit. The National Credit Union Administration (NCUA) supports the goals of the Proposed Rule, including ensuring that the protections of MLA apply broadly to predatory lending practices. NCUA will limit its comments on the Proposed Rule to recommending that the Department protect a responsible alternative to predatory payday loans.<sup>2</sup> Specifically, NCUA requests that the Department exempt payday alternative loans (PALs) made in accordance with NCUA's PALs regulation from coverage by the expanded definition of "consumer credit" under the Proposed Rule.<sup>3</sup>

NCUA, an independent federal agency within the executive branch, is the chartering authority for federal credit unions (FCUs) and provides federal account insurance to all FCUs as well as to state-chartered credit unions by application. As such, NCUA is the federal regulator for approximately 6,350 federally insured credit unions. NCUA works to ensure safety and soundness as well as compliance with applicable federal regulations in the credit union system.

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<sup>1</sup> Limitations on Terms of Consumer Credit Extended to Service Members and Dependents, 79 FR 58602 (proposed Sept. 29, 2014) (to be codified at 32 CFR 232).

<sup>2</sup> NCUA's comments focus on responding to Question 5 posed in the supplementary information to the Proposed Rule, which reads:

If the Department continues to pursue an approach that defines "consumer credit" to be generally consistent with certain credit regulated under [the Truth in Lending Act], should the Department consider including one or more exemptions for certain types of credit products, such as student loans? What legitimate basis could there be for any particular exemption for certain credit products?

<sup>3</sup> NCUA's PALs regulation is codified at 12 CFR 701.21(c)(7)(iii).

Credit unions are not-for-profit, member-owned, democratically controlled cooperative financial institutions formed to permit groups of people to save, borrow, and obtain financial services. These characteristics make credit unions unique among financial institutions. Further, approximately 30 percent of members of FCUs with an occupation-based charter belong to a credit union classified as “military” or “multiple group-primarily military.”<sup>4</sup> Given this fact, NCUA has a particular interest in ensuring that Service members and their dependents receive strong consumer protections while retaining access to affordable financial services.

The Federal Credit Union Act (FCU Act) and its implementing regulations contain protections that apply to all credit extended by FCUs. For example, FCUs are subject to a rate cap that currently is set at 18 percent (but can have a rate up to 1,000 basis points higher for PALs) and are prohibited from charging a penalty to any borrower who prepays an extension of credit.<sup>5</sup> Further, the NCUA Board has worked to promote responsible lending practices, in particular by establishing a regulation that permits FCUs to make PALs that are significantly less expensive for consumers than payday loans.

It should be noted that NCUA strongly supports the Department’s efforts to enhance protections available to Service members and their dependents when they obtain consumer credit. The Department has conducted research and issued reports regarding ways to better protect these borrowers, and its Proposed Rule reflects careful consideration of the costs and benefits of expanding the coverage of the MLA regulations to a wider range of credit products. Having worked to establish a regulation allowing FCUs to originate PALs as a responsible alternative to predatory payday loans, NCUA understands the challenges the Department faces in balancing concerns about access to credit with the desire to increase consumer protections for Service members and their dependents.

NCUA believes that its regulation permitting PALs appropriately balances these considerations. Accordingly, NCUA respectfully requests that the Department exempt PALs made in accordance with NCUA’s PALs regulation from the definition of “consumer credit” under the MLA regulations.

A. *Expanding the Definition of “Consumer Credit”*

A key element of the Department’s Proposed Rule is to expand the definition of “consumer credit” subject to the regulations to cover credit other than payday loans, vehicle title loans, and

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<sup>4</sup> As a percentage of members of all FCUs, both with occupation-based charters and community charters, the percentage is 22 percent.

<sup>5</sup> NCUA, Letter to Federal Credit Unions 14-FCU-02 (Jan. 2014), available at <http://www.ncua.gov/Resources/Documents/LFCU2014-02.pdf> (announcing the extension of the general 18 percent rate ceiling on FCU loans and the 28 percent rate ceiling on PALs through Sept. 10, 2015); NCUA, Board Action Bulletin (Jan. 23, 2014), available at <http://www.ncua.gov/about/Documents/Board%20Actions/BAB20140123.pdf> (same); 12 U.S.C. 1757(5)(A)(viii) (prohibiting FCUs from charging a penalty in connection with prepayment of a loan or line of credit); 12 CFR 701.21(b)(6) (same). The rate cap for most FCU loans has been set at 18 percent since May 1987. For purposes of the cap, the rate is “inclusive of all finance charges.” 12 U.S.C. 1757(5)(A)(vi).

tax-refund anticipation loans, as defined by MLA regulations. Specifically, the Department proposes to define “consumer credit” as “credit offered or extended to a covered borrower primarily for personal, family, or household purposes, and that is: (i) Subject to a finance charge; or (ii) payable by written agreement in more than four installments.” This definition would be consistent with the definition under Regulation Z, 12 CFR 1026, which implements the Truth in Lending Act. Exceptions would continue to apply for residential mortgages, vehicle-purchase credit transactions secured by the vehicle, personal property-purchase transactions secured by the personal property, and credit transactions exempt under Regulation Z.

Both currently and under the Proposed Rule, covered “consumer credit” transactions are subject to a 36 percent “military annual percentage rate” (military APR) cap, calculated to include certain fees not included when calculating the annual percentage rate (APR) under Regulation Z.<sup>6</sup> The transactions also cannot involve a variety of credit practices, among them: allowing rollovers, renewals, or refinancings, unless it results in more favorable terms; requiring waiver of legal recourse; requiring mandatory arbitration; demanding unreasonable notice before legal action; using a check or other method of access to a financial account, unless an exception applies; requiring a Service member allotment; and charging prepayment penalties.<sup>7</sup>

In the supplementary information to the Proposed Rule, the Department discusses the costs and benefits of the proposed expansion of the definition of “consumer credit.” The supplementary information states that—

[t]he Department continues to believe that certain payday loans, vehicle title loans, and refund anticipation loans present the most severe risks to Service members and their families, and remains mindful that more broadly defining the ‘consumer credit’ that would be subject to 10 U.S.C. 987 may present unintended consequences, including a reduction in ‘credit availability.’ At the same time, however, the Department recognizes—particularly in light of its experiences administering the existing regulation—that a broader range of closed-end and open-end credit products carry high costs, many of which far exceed the interest-rate limit established in 10 U.S.C. 987(b), and thereby pose the risks to Service members and their families that the Department has long sought to significantly reduce or eliminate.

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<sup>6</sup>Application fees charged to all applicants and participation fees are among the charges currently included in the military APR even though they may be excluded from the definition of “finance charge” in Regulation Z. *See* 32 CFR 232.3(h)(1)(i),(ii) (providing that the military APR includes fees while not excluding application fees and participation fees); 12 CFR 1026.4(c)(1), (4) (excluding application fees (if charged to all applicants) and participation fees from the definition of “finance charge”). The Proposed Rule specifically provides (in proposed 32 CFR 232.4(c)(3)(B) and (C)) that the military APR would include application fees and participation fees. 79 FR 58638.

<sup>7</sup> Both under the current regulations and the Proposed Rule, creditors would need to make certain disclosures about the military APR and protections available to Service members.

To obtain information to facilitate the Department's goal of limiting adverse unintended consequences while protecting Service members and their dependents, the Department asks for comment on a variety of issues related to the proposed expansion of the definition of "consumer credit."

In Question 5 in the supplementary information to the Proposed Rule, the Department requests comment on whether it should consider exemptions from the revised definition of "consumer credit" for certain types of credit products and asks the legitimate basis for such exemptions.<sup>8</sup> NCUA respectfully submits that PALs originated by FCUs in accordance with NCUA's PALs regulation should be exempt from coverage by the expanded definition of "consumer credit."<sup>9</sup> For the reasons described below, NCUA believes that PALs provide a responsible alternative to the risky, high-cost payday loans of primary concern to the Department.

*B. Benefits of PALs as a Responsible Alternative to Predatory Payday Loans*

In 2010, NCUA issued a regulation establishing the regulatory framework for PALs.<sup>10</sup> In both design and practice, PALs are short-term, small-dollar loans offered at significantly lower cost than payday loans, with no rollovers. The PALs regulation reflects NCUA's careful deliberation about how to develop a product that would enable FCUs to offer their members a reasonable alternative to high-cost payday loans. PALs have beneficial features that protect borrowers, and the evidence to date shows that PALs are considerably cheaper than payday loans.

Specifically, the PALs regulation allows: (a) small loan amounts of \$200 to \$1,000 to borrowers who have been members for at least one month; (b) short terms of one to six months; (c) an application fee that reflects the *actual costs* associated with processing the application, not to exceed \$20; (d) no rollovers; and (e) a rate up to 1,000 basis points above the maximum rate FCUs may charge for other credit (currently 18 percent, meaning FCUs at present may charge a rate up to 28 percent for a PAL), if FCUs meet all PAL requirements.<sup>11</sup> FCUs may not make more than three PALs in any rolling six-month period to any one borrower and may not make

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<sup>8</sup> See 79 FR 58610.

<sup>9</sup> See 12 CFR 701.21(c)(7)(iii).

<sup>10</sup> See NCUA, Short-Term, Small Amount Loans, 75 FR 58285 (Sept. 24, 2010). In issuing the PALs regulation, NCUA considered the interaction between its regulation for PALs and the Department's existing regulations implementing MLA. See 75 FR 58286. The Department's current MLA regulations define payday loans in part as loans for which a consumer provides a check or other payment instrument or authorizes a debit transaction contemporaneously with the receipt of funds. 32 CFR 232.3(b)(1)(i)(A), (B) (defining "consumer credit" in the context of payday loans). NCUA determined that PALs could be made without violating the Department's regulations, because FCUs making PALs would not need to take a check or other payment instrument or be authorized to debit a consumer's account when extending credit (and are prohibited from conditioning credit on a member's consent to electronic debit). See 75 FR 58286 (discussing the interaction between DOD and NCUA regulations).

<sup>11</sup> 12 CFR 701.21(c)(7)(iii)(A)(I)-(2), (7). The rate includes interest and finance charges. 12 U.S.C. 1757(5)(A)(vi) (stating that the FCU rate cap is "inclusive of all finance charges"; 12 CFR 701.21(b)(7) (same). The prohibition against rollovers does not apply to an extension of the loan term, up to six months total, provided the FCU does not charge any additional fees or extend new credit.

more than one PAL at a time to a borrower.<sup>12</sup> PALs must amortize fully.<sup>13</sup> Further, FCUs must implement appropriate underwriting guidelines to minimize risk, for example, by requiring a borrower to verify employment by producing at least two pay stubs.<sup>14</sup>

NCUA's PALs regulation also provides guidance about features that may improve the success of a PAL program and enhance member benefits, specifically including reporting of payments of PALs to credit bureaus, incentivized use of payroll deductions, financial education, a savings component, and electronic transactions.<sup>15</sup> Based on FCUs' Call Report data for the second quarter of 2014, 75 percent of FCUs made reporting payments to a credit bureau a condition of the PAL, 69 percent provided for payroll deductions, 38 percent required financial education, and 19 percent included a savings component.<sup>16</sup>

The PALs regulation has been very helpful in allowing FCUs assist their members, including those of modest means, to meet their short-term emergency cash needs. More than 500 FCUs now offer affordable short-term, small-dollar loans in compliance with NCUA's PALs regulation. PAL originations increased from about 98,000 in 2011 to 143,000 in 2013. Dollar volume of PALs originated has grown by double-digit percentages during each of the last three calendar years. In 2013, PAL originations totaled \$90 million, with an average loan balance of \$630 and a median interest rate of 24.6 percent.<sup>17</sup>

PALs serve as a viable alternative to predatory payday loans and can help members avoid or end dependency on those loans. In fact, the Department's report on enhancing protections on consumer credit for Service members and their dependents cites PALs as an example of "small dollar loans designed to assist Service members who appear to need a way out of unmanageable debt."<sup>18</sup>

Making the conservative assumption that FCUs consistently charge a \$20 application fee, the highest application fee allowed under NCUA's PALs regulation, we can estimate that the average "APR"—including the application fee—for a 30-day PAL at the 2013 median rate for PALs of 24.6 percent and average loan size of \$630 is approximately 63 percent.<sup>19</sup> The total

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<sup>12</sup> 12 CFR 701.21(c)(7)(iii)(A)(3).

<sup>13</sup> 12 CFR 701.21(c)(7)(iii)(A)(5).

<sup>14</sup> 12 CFR 701.21(c)(7)(iii)(A)(8).

<sup>15</sup> 12 CFR 701.21(c)(7)(iii)(B)(I).

<sup>16</sup> NCUA does not collect Call Report data on the use of electronic transactions for PALs.

<sup>17</sup> NCUA provides year-to-date calculations for 2013 because PALs turn over relatively quickly. Alternatively, one can determine average loan size by dividing the outstanding balance sheet amount at a point in time by the outstanding number of loans at that time. At the end of the fourth quarter of 2013, FCUs had an aggregate outstanding balance of \$27 million in PALs, with an average loan balance of \$417. At the end of the third quarter of 2014, FCUs had an aggregate outstanding balance of \$32 million in PALs, with an average loan balance of \$409.

<sup>18</sup> Department, Report: Enhancements of Protections on Consumer Credit for Members of the Armed Forces and Their Dependents 14-15 (Apr. 2014).

<sup>19</sup> Under Regulation Z, an application fee charged to all applicants for credit is not a finance charge included in calculating the APR. See 12 CFR 1026.4(c). However, for illustrative purposes, we provide an "APR" for PALs that includes the application fee. NCUA's Call Report does not capture information about the actual application

cost of this loan to the borrower would be approximately \$33. A three-month loan at the same rate would have a total cost of \$58 and an “APR” including the application fee of 37 percent; a six-month loan would have a total cost of \$96 and an “APR” of 31 percent.

For comparison purposes, one can compare this to the APR at the standard \$15 per \$100 payday rates, with a term of 14 days and one rollover; these assumptions are consistent with the median fee and rollover behavior as described in research the Consumer Financial Protection Bureau (CFPB) has conducted.<sup>20</sup> Such a payday loan would cost the borrower \$189 and have an APR of over 390 percent.

Further, PAL borrowers are significantly less likely than payday loan borrowers to be delinquent. As of the end of the second quarter of 2014, the aggregate delinquency rate for PALs was 2.83 percent. CFPB has found that 20 percent of payday loan borrowers defaulted during the study period.<sup>21</sup> Although delinquencies and defaults are not the same, borrowers generally are deemed delinquent before they are deemed to be in default. Therefore, the percentage of payday loan borrowers who are delinquent likely is higher than 20 percent.

Expanding the definition of “consumer credit” as proposed would prohibit certain PALs to covered borrowers that are permissible under NCUA’s PALs regulation. This is because application fees are included in the military APR, whereas they are not included in applying the 28 percent rate cap under the PALs regulation.<sup>22</sup> In applying the rate cap under the FCU Act, which is “inclusive of finance charges,” NCUA interprets the term “finance charge” consistently with the definition of the term under Regulation Z.<sup>23</sup>

PALs made in small dollar amounts and with short terms may have military APRs that exceed 36 percent, depending on the amount of the application fee. As discussed above, NCUA’s PALs regulation permits FCUs to charge only the *actual costs* associated with processing a PAL application, up to \$20. This provision is designed to ensure FCUs earn income and address risk through a PAL’s interest rate, not through an excessive application fee. NCUA respectfully submits that a PAL with a military APR exceeding 36 percent is still a responsible credit product and that PALs should not be subject to the 36 percent military APR cap.

If PALs are subject to MLA regulations, FCUs that originate PALs will face the burden of setting up separate origination processes for PALs made to covered borrowers and to non-

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fees charged. As discussed above, FCUs may charge only an amount that reflects the actual costs of processing a PAL, which may be less than \$20. Anecdotal evidence suggests that at least some credit unions do charge less than \$20.

<sup>20</sup> See CFPB, Payday Loans and Deposit Advance Products: A White Paper of Initial Data Findings 15-16 (Apr. 24, 2013).

<sup>21</sup> CFPB, CFPB Data Point: Payday Lending 26 (Mar. 2014).

<sup>22</sup> See 10 U.S.C. 987(i)(4) (defining “annual percentage rate” for purposes of MLA); 32 CFR 232.3(h) (defining “military annual percentage rate”); 79 FR 58637 (in the Department’s proposed 32 CFR 232.3(n), defining “military annual percentage rate”).

<sup>23</sup> See 12 CFR 1026.4(c)(1), (4) (excluding from the definition of “finance charge” application fees charged to all applicants for credit regardless of whether credit is extended and fees for participation in a credit plan).

covered borrowers. These costs in time, money, and human resources may cause some FCUs to discontinue making PALs and other FCUs not to begin making them. This is particularly true given that PAL programs typically have tight operating margins.

FCUs that continue to make PALs may choose to originate loans with a loan amount high enough or a loan term long enough, or both, to ensure the military APR is lower than 36 percent. Although some borrowers would benefit from this change, others would end up borrowing more than they need to borrow or paying more in interest than they would pay if they paid the loan off in a shorter time period.<sup>24</sup>

For all of the reasons cited in this comment letter, we believe it would be reasonable for the Department to exempt from coverage PALs made by FCUs in compliance with NCUA's PALs regulation. The 28 percent rate cap applicable to PALs includes all finance charges, as defined under Regulation Z. Further, the FCU Act and NCUA's PALs regulation provide other meaningful protections for borrowers, including a prohibition of prepayment penalties and rollovers.

Therefore, NCUA recommends that the Department exempt PALs from coverage by the Proposed Rule, in order to preserve a viable alternative to predatory payday loans.

Thank you for considering these comments. If it would be helpful for Department staff to obtain further information regarding PALs, please feel free to contact Jamie Goodson, Director, Division of Consumer Compliance Policy and Outreach, Office of Consumer Protection, at (703) 518-1140.

Sincerely,

/s/

Debbie Matz  
Chairman

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<sup>24</sup> This statement assumes that borrowers will incur the same application fee regardless of loan amount. As discussed above, borrowers may prepay loans from FCUs without penalty.