December 23, 2014

Federal Docket Management System Office
4800 Mark Center Drive
2nd Floor, East Tower
Suite 02G09
Alexandria VA 22350-3100

RE: Docket ID DOD-2013-OS-0133
RIN 0790-AJ10

Dear Sirs,

The Center for Financial Services Innovation (CFSI) is submitting this letter in response to the request for comment by the Department of Defense (DOD, the Department), published on September 29, 2014. We appreciate the opportunity to respond to the DOD’s request for comments on proposed revisions to the Military Lending Act (MLA). Like you, we recognize the important role that financial services and financial service providers play in the lives of service members and their families and we are committed to promoting high-quality financial products. We believe that financial services can be a force for good in people's lives and that meeting consumer need responsibly is ultimately good for both the consumer and the provider.

CFSI is a national authority on consumer financial health. We lead a network of financial services innovators committed to building higher quality products and services. CFSI informs, advises, and connects its network to seed innovation that will transform the financial services landscape. Our vision is to see a strong, robust, and competitive financial services marketplace, where the diversity of consumer transaction, savings, and credit needs are met by a range of providers offering clear, transparent, and high-quality products and services at reasonable prices. This vision is guided by our Compass Principles – Embrace inclusion, Build trust, Promote success, and Create opportunity. These principles are built on a solid foundation that recognizes the core market values of profitability and scalability, deep customer knowledge, safety, variation and choice, consumer-provider relationships, and cross-sector participation.

Overview

CFSI believes that access to high-quality financial services is necessary for consumers’ financial health and any clarity that the Department can provide in revisions to the MLA is welcome. The Department’s proposal extends the types of consumer credit covered under the MLA to include a broader set of credit products and services, beyond short-term, small-dollar loans. We believe a broad set of criteria should be used to define a quality credit product across the marketplace (see our Compass Guide to Small Dollar Credit), but if the MLA rules are going to apply, they should apply equally to all products. This will help both covered borrowers (borrowers) and lenders in credit markets. Borrowers will benefit by receiving high-quality credit products. Having a
consistent set of rules to ensure access to quality credit will help lenders by having a standard and level playing field, and unscrupulous lenders will no longer be able to “game the system.”

The proposal also better aligns the MLA with the Truth in Lending Act (TILA) and its implementing regulation, Regulation Z (Reg Z). This will help reduce both the disclosure and compliance burdens for financial institutions and other financial service providers, who will no longer have to worry about double sets of disclosures. And this may reduce any confusion on the part of the borrower who might have received both TILA and MLA disclosures.

The Department’s proposal extends important consumer protections, including clear disclosures and no prepayment penalties. While we believe these provisions are important to consumers, the Department may need to provide additional implementation time for institutions to make adjustments in their contracts – for example, arbitration clauses are often included in many standard contracts with financial institutions.

**Defining High Quality in Financial Markets**

Access to high-quality credit, including small-dollar credit, is a key component of a successful financial life for many service members. Having the ability to borrow relatively small sums, on reasonable terms, can help individuals weather a financial shock, smooth income fluctuations, build a positive credit history, and facilitate a wealth-building purchase. CFSI believes the opportunity and need are great to improve the marketplace for credit, including small-dollar credit. Well-designed products have the potential to help people turn a momentary credit need into an opportunity to improve their financial well-being and financial health. To this end, CFSI convened a network of expert advisors from the financial services and consumer advocacy communities to develop a set of specific guidelines and best practices for high-quality small-dollar credit as part of our Compass Principles program.

CFSI’s [Compass Guide to Small-Dollar Credit](#) established seven guidelines for high-quality small dollar loans as ones that:

1. Are made with a high confidence in the borrower’s ability to repay
2. Are structured to support repayment
3. Are priced to align profitability for the provider with success for the borrower
4. Create opportunities for upward mobility and greater financial health
5. Have transparent marketing, communications, and disclosures
6. Are accessible and convenient
7. Provide support and rights for borrowers

We encourage the Department to consider incorporating these principles and guidelines in this and future revisions to the MLA. The Department should consider the total structure of the credit or loan product – it is the combination of the term, payment schedule, underwriting, and flexibility of payments in addition to the interest rate that define a quality product, not interest rate alone.

Similarly, we encourage the Department to consider recent innovations and changes in delivery channels and consumer behaviors as you revise the MLA. In today’s market, service members
may be interacting with bank or credit union branches and stores, but they are more likely to be using online, mobile, self-serve kiosks, and hybrid-video ATMs, as well as other future access and delivery systems. They may be able to open accounts and apply for credit via mobile devices or online, away from the traditional delivery channels. Compliance with and enforcement of the MLA will need to account for these variations.

**Availability and Access to Credit**

It is always difficult to assess the impact of any proposed regulation on credit availability and consumers’ access to credit, but this rule raises the very real possibility that consumers would either have to take out a larger loan than they need or may not have access to credit at all. Your example (Federal Register, page 58619, column 1), demonstrates that a $500 loan with a 8.25% interest rate and a $25 fee would not meet the MAPR standards (68.25% MAPR), whereas a $1,400 loan at the same contract interest rate and a $25 fee would meet the standards (24.73% MAPR). This example again makes our point that defining quality solely with an APR cap can be counterproductive. The implication is that lenders may not be able to make smaller loans and borrowers would be placed in the position of having to take out larger loans than necessary, with a potentially higher overall cost (if the larger loan is spread over a longer term). Obviously, it is not in the borrower’s best interest to take out a loan for more than is needed. It may also be the case that some borrowers might qualify for a $500 loan but may not qualify for a larger loan, and thus would not be able to access the credit they need.

**Consistency in Financial Markets**

Service members should know what to expect when they choose and use financial products and services – having a consistent experience can reinforce good financial behaviors. In a similar vein, financial services providers want consistent standards and a level playing field in which to operate. For example, we encourage the Department to provide consistent rules across similar product lines. Lines of credit, whether offered through deposit accounts, credit cards, or signature loans, should be subject to the same set of rules regardless of the mechanism used to access the funds or the channel through which the consumer applied for the loan. Consumers will know what to expect and lenders will not be incentivized to shift from offering one form of credit to another.

**APR Issues**

Since the Department is aligning the MLA with TILA, and for the sake of consistency, we suggest you consider extending TILA’s APR definition to the MAPR. This would simplify compliance for lenders and may reduce confusion for consumers.

If the Department amends the language of §232.4 (c)(1)(ii) so that the MAPR includes “fees for credit-related ancillary products, with respect to open-end credit, sold either upon account opening or at any time during the existence of the account” (italics added), then the borrower also needs to understand that the change in MAPR is due to the ancillary products, not due to any
other adjustments in interest rates. Also, given the periodic nature of the APR/MAPR disclosure in open end credit, financial service providers would need guidance on incorporating annual versus monthly fees in their APR/MAPR calculations.

**Definition of Terms**

We urge you to adopt all the definitions provided in Reg Z and not to provide an exception for consumer credit in §232.3 (f)(2). The Consumer Financial Protection Bureau (CFPB, the Bureau) is currently working on rules for both small-dollar credit and overdraft, and the Bureau is likely to work on other credit products in the future. Adopting Reg Z definitions for the MLA will enable financial institutions to stay in compliance as the Bureau issues new rules, and will provide service members with a consistent source of information.

Similarly, we would urge the Department to adopt the same “reasonable and proportional” standard for fees as established by the CARD Act and as published in Regulation Z – for example the fee limits in §1026.52 Limitations on Fees – instead of the “reasonable” and “customary” standards proposed under §232.4(d)(3)(ii). Again, our concern here is that financial institutions will have to apply different standards for non-military customers than for military customers. It is critically important to be clear about definitions here – the risk is that the rule may end up perpetuating the use of technicalities to avoid the requirements of the regulation. Further, it is unclear how the “reasonable” and “customary” standards would be enforced by examination staff.

**Disclosures**

CFSI believes that transparent marketing, communications, and disclosures are important for high-quality small-dollar credit. The Department may want to consider innovative ways to provide disclosures and information not only “in writing in a form the borrower can keep” (Federal Register, page 58621) and oral disclosures in some circumstances, but also via other media. For example, service members may pay more attention to disclosures provided via video or online. They may also be more likely to retain and use disclosures that are provided electronically (saved on a mobile device, on a PC, or in cloud storage).

**MLA Database**

We applaud the Department for considering the need for a straightforward mechanism for a lender to assess whether an applicant is a covered borrower. However, the MLA Database as proposed may be problematic. It is a single point of failure and potential bottleneck for credit applications; if the lender cannot access the database (for example, if there are technical issues), the lender cannot process loan applications.

Given the structure of the rule, and depending on the communications efforts and mechanisms for supervision and enforcement, potentially all lenders would need to check all loan applicants, putting a substantial burden on lenders, on the database system, and on the examination staff tasked with ensuring compliance. For lenders in some communities – those with a local military installation, where service members and their families are a large proportion of the population –
the need to check all applicants within the MLA Database may not be onerous. But in communities with a more mixed population (for example, the Washington DC metro area), some financial service providers may not know of, or think about, the need to check applicants against the MLA Database.

The system would also have to be built and maintained to interface with emerging technology platforms to ensure that covered borrowers have access to the most recent innovations in technology that supports borrowing. Such a database and the technical protocols associated with it would have to keep up with the market; otherwise it would exclude covered borrowers from future innovations.

The option of allowing for use of a third-party provider is positive, but the rule makes no mention of the controls these providers will face nor where the responsibility for accuracy lies. The rule is also silent about the record retention rules that would apply – are these the same as other documents associated with the loan?

Another Model

The Department may want to take a different approach to helping service members address their credit needs. You may want to do some work to understand the business models of the high-cost lenders and where their key costs are, and then see if there are ways to address those costs. For example, we understand that online lenders costs are driven up significantly by lead generation and lead brokers. To overcome these acquisition costs, is there some way that DOD could put together a set of resources, an alliance of lenders, or a web portal for covered members to access compliant lending at lower costs? An analogy here is the Free File Alliance that provides consumers with access to tax preparation assistance through the IRS web site. With sufficient vision, the Department is a big enough entity to help move the market to higher quality via improved information and market forces via high-level principles rather than traditional rules.

We would also encourage the Department to conduct more frequent analyses of the financial status of service members to better assess their needs. The numbers you cite in the discussion on the financial status of members appear to be from 2006, before the financial crisis. In 2014, you may have new generations of members who are facing new financial products, services and technologies. You may find that a survey of service members today would produce different responses to some questions and new responses to others.

Conclusion

Access to high-quality credit, including small-dollar credit, is a key component of a successful financial life for many service members. Having the ability to borrow relatively small sums, on reasonable terms, can help individuals weather a financial shock, smooth income fluctuations, build a positive credit history, and facilitate a wealth-building purchase. Well-designed products built upon our Compass Guidelines have the potential to help people turn a momentary credit need into an opportunity to improve their financial well-being and financial health. We believe
that the total structure of the credit or loan product – the combination of the term, payment schedule, underwriting, and flexibility of payments in addition to the interest rate – define a quality product.

CFSI believes that access to high-quality financial services is necessary for consumers’ financial health and any clarity that the Department provides in revisions to the MLA is welcome. In a financial marketplace with high-quality credit products, borrowers will know what to expect when they choose and use financial products and services – having a consistent experience can reinforce good financial behaviors. Financial service providers will benefit from a standard, consistent, and level playing field. We believe that financial services can be a force for good in people’s lives and that meeting consumer need responsibly is ultimately good for both the consumer and the provider.

Sincerely,

[Signature]

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