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11 June 2007

Federal Docket Management System Office  
1160 Defense Pentagon  
Washington DC 20301-1160

Re: RIN 0790-A120  
Limitations on Terms of Consumer Credit to Service Members and  
Dependents  
*72 Federal Register* 18157, April 11, 2007

Dear Sir or Madam,

The American Bankers Association (“ABA”) respectfully submits our comments to the Department of Defense’s (“The Department”) proposal to implement the consumer protections in Public Law 109-364, the John Warner National Defense Authorization Act for Fiscal Year 2007,) section 670, “Limitations on Terms of Consumer Credit Extended to Service Members and Dependents” (“Payday Loan Law”). The proposed rule is intended to regulate the terms of certain consumer credit to service members and their spouses and dependents.

We commend the Department for its thoughtful and balanced approach in implementing the Payday Loan Law that we believe will ensure that service members and their spouses and dependents continue to have access to important financial products. Nevertheless, we continue to believe that the best way to protect these individuals in their dealings with insured depository institutions is to rely on the extensive regulation and thorough supervision of banks and savings associations. Technical comments have been incorporated in our joint letter submitted with other bank trade associations.<sup>1</sup>

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<sup>1</sup> The ABA has set forth suggested technical changes in a letter date 11 June 2007 filed jointly with several other bank trade associations. We will not repeat those suggests, but note herein only that we firmly support the views expressed in the joint letter.

***The Department should rely on the existing system of depository regulation and supervision.***

As we have stated in prior submissions to the Department<sup>2</sup> we believe the most effective way to protect service members and their spouses and dependents in their dealings with insured depository institutions is to rely on the existing system of depository institution regulation and supervision. There simply is no need to add to the extensive set of rules and regulations that already apply to banks and savings associations. Conversely, there is a need to avoid the unintended, adverse consequences that coverage of these institutions could produce.

Banks and savings associations are subject to a set of laws that govern virtually every aspect of their relations with their customers. These rules have been developed over many years and reflect a balance of policy objectives that seek to ensure that all consumers are protected while permitting regulated institutions sufficient latitude to innovate. Banks and savings associations are examined frequently – in many cases, continually – for compliance with applicable laws. And banks and savings associations conduct business in an environment where public confidence is crucial to their success.

Thus, it is not surprising that the report that gave rise to the Payday Loan Law highlighted problems arising from payday lenders and other lenders who operate outside the consumer protections of the banking system. Simply put, banks and savings associations are not the problem.

We have heard it suggested that there is no harm in regulating a product that is not offered. Thus, the logic goes, if banks and savings associations are not offering products that are regulated by the Department's rule, they should not care if they are within the universe of covered entities. This logic ignores two realities: first, every rule, no matter how well written, contains ambiguities and thus may have unintended applications; and second, people will exploit the ambiguities to achieve objectives not intended by the drafters.

The current proposal contains a number of ambiguities, as discussed later in this letter and in the joint letter submitted by the bank trade associations. It is a virtual certainty that banks and savings associations will offer beneficial products in good faith that they believe fall outside the scope of the regulation only to be told by a plaintiffs' lawyer

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<sup>2</sup> See Joint letter from the ABA, America's Community Bankers, Association of Military Banks in America, Independent Community Bankers Association, Financial Services Roundtable, and Consumer Bankers of America to Department dated 11 June 2007; letter from Wayne Abernathy, Executive Director of Financial Institutions Policy and Regulatory Affairs, ABA, to Dr. David S. C. Chu, Under Secretary of Defense for Personnel and Readiness, dated 23 January 2007.

that a product violates the Payday Loan Law. The merits of such allegations often take a back seat to the business concerns about the expense of defending a class action. Banks and savings associations, faced with the prospect of a host of loans being deemed void from the date of inception or having a bank officer taken away in handcuffs, may well decide to avoid offering any product that comes anywhere close to being covered by the rule. This includes, for example, innovative small dollar, short-term loan products that the Department and policy makers agree benefit service members and their spouses and dependents.

The resulting diminution in credit products would serve no one's interest. These unintended consequences can best be avoided by applying the proposed regulation solely to those lenders who are not subject to the system of bank supervision and regulation that protects customers of insured depository institutions.

***If the Department overrides existing the existing regulatory framework, we support the focused approach of the proposed regulation.***

We believe that the proposal addresses the intended target of the legislation, that is, predatory loans, while minimizing the unintended consequences that could harm service members and their spouses and dependents. Applying the regulation more broadly than proposed would, in effect, put mainstream financial products out of reach for service members and their spouses and dependents. If the Department chooses to override the existing system of bank regulation and supervision, the Department's focused approach is the next best way to ensure that service members and their spouses and dependents will continue to have access to those important mainstream products.

We also support the Department's flexibility in interpreting the provisions related to the restrictions and disclosure requirements for covered loans. Nonetheless, despite the Department's practical approach, those provisions pose significant challenges. The burdens associated with these provisions will strongly discourage depository institutions from offering any covered loan to service members and their spouses and dependents. Accordingly, if the regulation were expanded to cover a wider range of financial products, because of the restrictions and disclosure requirements imposed on covered loans, service members and their spouses and dependents would have fewer credit choices and face higher credit costs. This includes their access to affordable small dollar loans and work-out loans.

It is critical that the final regulation retain its targeted approach so that service members and their spouses and dependents continue to have

access to mainstream products. While the Department has demonstrated flexibility in interpreting the substantive provisions of the statute, the burden of compliance along with the consequences for violations – including voidance of the loan and criminal sanctions -- will make offering covered loans to service members and their spouses and dependents extremely risky. Burdens associated with offering covered loans to service members and their spouses and dependents include:

- **Requirement to calculate and disclose the military annual percentage rate (“MAPR”).** Currently, lenders calculate an annual percentage rate (“APR”) as required under Regulation Z, the regulation implementing the Truth in Lending Act. For covered loans, lenders would have to create programs to provide this additional calculation. In addition, they would have to dedicate resources to respond to confused borrowers with explanations of the difference between the two terms.
- **Oral disclosure requirements.** While the Department has attempted to make the oral disclosure requirements more workable, the requirements will nonetheless require lenders offering covered loans to service members and their spouses and dependents to create and maintain dedicated systems to provide the oral disclosures.
- **Vague and subjective prohibitions.** The statute and proposed regulation prohibit provisions which impose “onerous legal notice provisions,” “waivers of the right to legal recourse,” and “unreasonable notice from the covered borrowers as a condition for legal action.” However, neither examples nor an exclusive list are offered, leaving lenders at the mercy of creative and motivated plaintiffs’ attorneys.

To avoid these requirements and potential liability, depository institutions will avoid making covered loans to service members and their spouses and dependents. Thus, it is critical that the proposed regulation rely on existing bank regulation and supervision, or, at a minimum, retain its focused approach to ensure that important credit products remain available to service members and their spouse and dependents.

### **Conclusion.**

The ABA appreciates the opportunity to comment on this important proposal. We continue to encourage the Department to rely on the existing regulatory and supervisory framework for depository institutions, which we believe will best ensure that our service members and their spouses and dependents will continue to have access to the full menu of important, mainstream bank products. If the Department chooses to

override that framework, we support the Department's targeted approach, which balances the need to address lending abuses without depriving service members and their spouses and dependents of beneficial financial products.

Sincerely,

Wayne A. Abernathy  
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Financial Institutions Policy  
And Regulatory Affairs