

## **RULE DATA**

**TITLE:** Limitations on Terms of Consumer Credit Extended to Service Members and Dependents

**RIN:** 0790-AI20

**STATEMENT OF NEED:** Regulation 32 CFR 232 (the Regulation) identifies the negative impact of predatory consumer credit lending on Service members' and their dependents' quality of life and on general troop readiness. Service members are younger than the population as a whole, with 46 percent 25 years old or less. Thirty-eight percent of Service members 25 years old or less are married and 21 percent of them have children. This is compared with approximately 13 percent of their contemporaries in the US population 18 through 24 who are married (2000 Census). The majority of recruits come to the military from high school, with little financial literacy education.

The initial indoctrination provided to Service members is critical, providing basic requirements for their professional and personal responsibilities and their successful adjustment to military life. Part of this training is in personal finance, which is an integral part of their personal, and often, professional success. The Department of Defense (the Department) continues to provide them messages to save, invest, and manage their money wisely throughout their career.

A major concern of the Department has been the debt trap some forms of credit can present for Service members and their families. The combination of little-to-no regard for the borrower's ability to repay the loan, unrealistic payment schedule, high fees and interest, and the opportunity to roll over the loan instead of repaying it, can create a cycle of debt for financially overburdened Service members and their families.

Service members and their families are experiencing the sixth year of the Global War on Terror. The Department views the support provided to military families as essential to sustaining force readiness and military capability. From this perspective, it is not sufficient for the Department to train Service members on how best to use their financial resources. Financial protections are an important part of fulfilling the Department's compact with Service members and their families.

**SUMMARY OF THE LEGAL BASIS (include specific citation for the statute, order, or other legal authority):** The Department of Defense (the Department or DoD) is amending 32 CFR by adding a new part 232 to implement the consumer protections provisions of Public Law 109-364, the John Warner National Defense Authorization Act for Fiscal Year 2007, § 670, "Limitations on Terms of Consumer Credit Extended to Service Members and Dependents" (October 17, 2006). Section 670 of Public Law 109-364, which was codified as 10 U.S.C. § 987, requires the Secretary of Defense to prescribe regulations to carry out the new section.

**ALTERNATIVES:** 10 U.S.C. §987 is effective October 1, 2007 with or without implementing regulations; however, numerous financial institutions and their trade associations voiced their concern about the significant unintended consequences that would occur without implementing regulations. Financial institutions anticipated the statute significantly limiting the availability of

favorable credit for Service members and their families without the definitions the Congress anticipated the Department would develop as part of the Regulation. As a consequence, there is no effective alternative to providing the Regulation.

**ANTICIPATED COST AND BENEFITS:** Increased costs to the creditors as a result of the Regulation have been articulated in the Paperwork Reduction Act Submission as part of the EO 12866 review. Annualized costs to respondents are estimated at \$192,000 with approximately \$8,000 in start-up costs. Estimates on the amount of excessive interest and fees paid by Service members and their families ranges as high as \$80 million per year ("Payday Lenders Target the Military," Center for Responsible Lending, September 2005). The Regulation is anticipated to limit the potential for Service members and the families to be charged high fees for credit.

**RISKS:** The Regulation covers payday loans, vehicle-title loans and refund anticipation loans (RALs). Some other credit products with favorable terms as well as terms that can increase the interest rate well beyond the limits prescribed by 10 U.S.C. § 987 were not covered by the Regulation. Isolating detrimental credit products without impeding the availability of favorable credit products was of central concern in developing the regulation. The protections posed in the statute assist Service members, when applied with precision to preclude unintended barriers. The regulation applies the protections in 10 U.S.C. § 987 to forms of credit that are accessed by Service members who need forms of financial assistance other than high-cost short-term loans to resolve their financial problems. These loans have been succinctly defined in order to preclude potential unintended consequences.

The Regulation also complements other actions taken by the Department, to include initial and follow-on financial education, financial awareness campaigns, savings campaigns, free financial counseling at military installations and available 24 hours -7 days per week through Military OneSource. To complement these efforts, Military Aid Societies provide grants and no-interest loans, and a growing number of financial institutions located on military installations are providing low-cost small-dollar loans. The Federal Deposit Insurance Corporation (FDIC) has issued guidelines to assist financial depository institutions provide low-cost small-dollar loans, and has also established a pilot program of member banks to produce these kinds of credit products.

**MARKET FAILURE STATEMENT:** The Regulation intends to address the negative impact posed by predatory lending practices on national defense in the form of decreased Service member readiness. Payday loans and vehicle-title loans have little-to-no regard for the borrower's ability to repay the loan, unrealistic payment schedules, high fees and interest, and the opportunity to roll over the loan instead of repaying it, which can create a cycle of debt for financially overburdened Service members and their dependents. While RALs do not create a cycle of debt; these loans carry high interest rates and fees. The Department strongly advocates Service members and their dependents place a portion of their tax-return (which is normally not part of the monthly family budget) into savings instead of paying these high costs to receive their refund 7 to 14 days earlier than through electronic filing methods.