



**VETERANS
EDUCATION SUCCESS**

STATEMENT FOR THE RECORD

**SUBMITTED TO THE
HOUSE COMMITTEE ON FINANCIAL SERVICES**

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Chairwoman Waters, Ranking Member McHenry and Members of the Committee on Financial Services,

Veterans Education Success (VES) is a nonprofit 501(c)(3) organization dedicated to advancing higher education success for veterans, service members, and military families, and to protecting the integrity and promise of the GI Bill and other federal education programs.

In executing that mission, particularly when it comes to student loans, VES has found that the Consumer Financial Protection Bureau's (Bureau) Office of Servicemember Affairs (OSA) and Student Loan Ombudsman are extremely helpful in protecting the interests of servicemembers, veterans, their dependents and their survivors.

VES appreciates the opportunity to address the Committee about the Bureau's actions in regard to the Military Lending Act, the proposed changes to the Payday Rule, and the Consumers First Act.

MILITARY LENDING ACT

Broad bipartisan support led to enactment of the Military Lending Act in the Fiscal 2007 National Defense Authorization Act (FY '07 NDAA) in response to an escalating problem of military separations of servicemembers from service due to financial problems caused by predatory lending that the Department of Defense (DoD) had noticed over the preceding half-decade or so.

The MLA's provisions include:

- 36 percent annualized rate referred to as the Military Annual Percentage Rate (MAPR)
- Provides an optional safe harbor from liability for certain procedures that creditors may use in connection with identifying covered borrowers;
- Requires creditors to provide written and oral disclosures in addition to those required by Truth In Lending Act (TILA);
- Prohibits certain loan terms, such as prepayment penalties, mandatory arbitration clauses, and certain unreasonable notice requirements;
- Restricts loan rollovers, renewals, and refinancing by some types of creditors;

Amendments to the MLA in 2013 granted enforcement authority for the MLA's requirements to the agencies specified in section 108 of TILA. These agencies include the Board of Governors of the Federal Reserve System (Board), the Bureau, the Federal Deposit Insurance Corporation (FDIC), the National Credit Union Administration (NCUA), the Office of the Comptroller of the Currency (OCC), and the Federal Trade Commission (FTC).

2015 DoD revisions to the MLA implementing regulation enhanced the MLA by:

- Extending the MLA's protections to a broader range of credit products;
- Modifying the MAPR to include certain additional fees and charges;
- Altering the provisions of the optional safe harbor available to creditors for identification of covered borrowers;
- Modifying the disclosures creditors are required to provide to covered borrowers;
- Modifying the prohibition on rolling over, renewing, or refinancing consumer credit; and
- Implementing statutory changes, including provisions related to administrative enforcement and civil liability for MLA violations (for knowingly violating the MLA,

there is potential for criminal penalties). Participation fees generally must be included in the MAPR, but would not be included in the APR.¹

One way to measure the impact of the MLA's success is by tracking military relief society loans to servicemembers for payday loan problems. The Navy-Marine Corps Relief Society (NMCRS) provides zero-interest loans to Navy and Marine Corps active duty servicemembers and retirees. From 2004 until 2006 the NMCRS had annual requests for assistance with payday loans from on average more than 1500 active duty servicemembers, and over 100 retired servicemembers.²

Those numbers plummeted after the MLA took effect. In 2018, the Navy-Marine Corps Relief Society had to help only *three* servicemembers due to their involvement with payday loans, and 14 Navy or Marine Corps retirees. (The fact that more retirees are currently asking for help because of trouble with payday loans than active duty servicemembers is probably indicative of the fact that retirees are not protected by the MLA.)

This represents an approximately 99.8% reduction in financial distress among active duty sailors and marines caused by payday loans. Admittedly, the NMCRS does not see every single case of financial distress that occurs in the Department of the Navy, but the reduction gives a fairly accurate sense of the current scale of the problem. The MLA is inarguably an incredibly successful federal consumer protection law.

The importance of the MLA to DoD is also reflected in its position in the Federal Code. DoD has been described in the past by military personnel advocates as being 'allergic' to taking on missions that are not viewed as part of its core war-fighting mission. The Servicemember Civil Relief Act, which has been codified in various forms since at least 1940, traces its roots back to the Civil War but is located at 50 U.S.C. § 3901.³ The Post 9/11 GI Bill, over which DoD retains the authority to set eligibility requirements for purposes of personnel retention, is located at 38 U.S.C. § 3301.

The MLA is located at 10 U.S.C. § 987, right in the heart of Title 10 and the law on military personnel. This reflects Congress and DoD's determination that the MLA is integral to its war-fighting mission.

Last Fall, news reports began to trickle out that the Bureau was considering halting supervisory examinations of lenders for MLA compliance.⁴ It has come to the attention of VES that while the Bureau has decided that it does not have sufficient authority to conduct supervisory examinations and in fact has halted them, to our knowledge none of the other federal financial regulators

¹ FDIC Consumer Compliance Examination Manual, V-13.1 (September 2016); *available at* <https://www.fdic.gov/regulations/compliance/manual/5/v-13.1.pdf>. (Last viewed: March 3, 2019)

² *Available at* <https://static1.squarespace.com/static/556718b2e4b02e470eb1b186/t/5c7d3ec0e79c70579f44162c/1551711937100/Navy-MarineCorps+Relief+PayDay+Loans.March2019.pdf>

³ Mason, R. Chuck (27 August 2014). "[The Servicemembers Civil Relief Act \(SCRA\): An Explanation](#)". U.S. Department of Justice. Congressional Research Service. (Last viewed: March 3, 2019)

⁴ Chris Arnold, White House Takes Aim at Financial Protections for Military NPR (2018), <https://www.npr.org/2018/08/13/637992389/white-house-takes-aim-at-financial-protections-for-military> (last visited Mar 4, 2019).

empowered by TILA to enforce the MLA (as mentioned earlier: the Board, the FDIC, the FTC, the NCUA, and the OCC) have taken a similar position.

There's a negative impact on business, too: Non-depository lenders that previously would have been warned about unintentional MLA violations and given the chance to correct their actions during supervisory examinations are instead now not given any supervisory check and allowed to continue violating the law (most likely unwittingly) and therefore becoming subject to the possibility of multi-million dollar fines. In fact, the Bureau's actions have created a situation where only one class of lender, non-depository lenders that otherwise escape scrutiny of financial regulators, enjoy the freedom from supervisory MLA examinations. Specifically, only payday lenders are currently excluded from supervisory exams. It could be said that through this action the Bureau is 'picking winners and losers' when it comes to financial regulation. There isn't a single business in America that would prefer to run the risk of seven-figure penalties versus being warned and given the option of correcting their behavior beforehand. This is the equivalent of regulatory Russian roulette.

Last year the Army failed to meet its recruiting target by 6,500 soldiers.⁵ The Marine Corps is offering up to \$70,000 retention bonuses to infantry squad leaders, which is historically high.⁶ At a time of sub-four percent unemployment it is extremely hard to find qualified people to serve in the United States Armed Forces. Additionally, DoD has put into place a policy of "Continuous Evaluation" (CE) of security clearance eligibility, meaning that servicemembers with security clearances will have their financial status reviewed in real time.⁷ Without the Bureau's vigilance, the tightening of the security clearance eligibility process will result in even more servicemembers unnecessarily losing their security clearances and most likely their careers.

Servicemember advocates have repeatedly sounded the alarm. They have written to the Administration⁸ that "the harm is not only to servicemembers. The harm also extends to the Pentagon's costs and military readiness. The Defense Department has explained:

“[T]he anticipated benefit of [ensuring the Military Lending Act's 36% interest rate cap] are the savings attributable to lower recruiting and training expenses associated with the reduction in involuntary separation of Service members where financial distress is a contributing factor. Each separation of a Service member is estimated to cost the Department \$58,250, and the Department estimates that each year approximately 4,640 to 7,580 Service members are involuntarily separated where financial distress is a

⁵ Meghann Myers, The Army Is Supposed To Be Growing, But This Year, It Didn't At All (September 2018), <https://www.armytimes.com/news/your-army/2018/09/21/the-army-is-supposed-to-be-growing-but-this-year-it-didnt-at-all/> (last visited March 4, 2019).

⁶ Shawn Snow, The Corps Is Dishing Out Big Bonuses for Grunts and Other Jobs. Here's What's in it For You (June 2018), <https://www.marinecorpstimes.com/news/your-marine-corps/2018/07/02/the-corps-is-dishing-out-big-bonuses-for-grunts-and-other-jobs-heres-whats-in-it-for-you/> (last visited March 4, 2019).

⁷ Anthony Camilli and Joshua Friedman, WARNO: New Security Clearance Guidelines Make it More Important Than Ever for Servicemembers To Monitor Their Credit (August 2018), <https://www.consumerfinance.gov/about-us/blog/warno-new-security-clearance-guidelines-make-it-more-important-ever-servicemembers-monitor-their-credit/> (last visited March 4, 2019)

⁸ Available at:

<https://static1.squarespace.com/static/556718b2e4b02e470eb1b186/t/5b907bc62b6a2870db064a79/1536195527148/MLA+Letter+w+Additional+signers+%28FINAL%29.Sept2018.pdf> (last visited March 4, 2019).

contributing factor. If the Department's proposed regulation could reduce the annual number of involuntary separations where financial distress is a contributing factor from between 5 to 30 percent, the savings to the Department could be in the range of approximately \$13.51 million to \$132.52 million each year."⁹

Enacting policies that have the potential to exacerbate the situation is curious to say the least. The Bureau has chosen a course of action that is bad for national security, bad for the Treasury, bad for the careers of individual servicemembers and bad for industry.

VES is aware of the fact that the Bureau has been unable to complete formal supervisory findings after examining non-depository lenders for MLA compliance. In a perfect world, the legal ambiguities that the Bureau's lawyers have identified would prompt quick action by Congress. Unfortunately, we don't live in a perfect world.

Thus, while we respect the Director's request for Congress to act to shore up legal authorities, we remain concerned about the negative impacts on national security, the Treasury, servicemembers' careers and non-depository lenders that unintentionally violate the MLA, as well as the potential for a lengthy legislative process that could drag on for years. The ghosts of old bills with powerful bipartisan support but never made it to a President's desk for signing are common on Capitol Hill.

We humbly request that while Congress considers the Bureau's request, the Bureau resume supervisory examinations for MLA compliance.

PAYDAY RULE

Last month the Bureau announced that it was reopening the "Payday Rule," specifically the underwriting provision called "ability to repay" that applies to payday, single-payment vehicle title and longer-term balloon payment loans.

In their 2006 report "Report on Predatory Lending Practices Directed at Members of the Armed Forces and Their Dependents," DoD called for there to be an ability to repay provision in what was to become the Military Lending Act.¹⁰ Unfortunately, that did not come to pass. But in 2017 the Bureau announced the Payday Rule, which had as its centerpiece such a provision.

'Ability to repay' a loan is not a foreign concept when it comes to basic principles of economics. As New Keynesian economists have explained:

"To be more concrete, let us use the 'good borrower, bad borrower' example. In writing a loan contract with a potential borrower, the bank has two polar options. First, it might try to approximate the complete state-contingent contract by making the borrower's actions part of the agreement and by allowing repayment to depend on the outcome of the borrower's project... [I]ts obvious drawback is the cost of monitoring that it involves.

⁹ 80 FR 43559 (July 22, 2015).

¹⁰ Report on Predatory Lending Practices Directed at Members of the Armed Forces and Their Dependents, 7 (2006), http://archive.defense.gov/pubs/pdfs/Report_to_Congress_final.pdf (last visited Mar 4, 2019).

The bank's other option is to write a very simple agreement ('payment of such amount to be made on such date') and then *to make the loan only if it believes that the borrower is likely to repay* (emphasis added). The second approach usually dominates the first, of course, especially for small borrowers."¹¹

VES considers the Payday Rule to be the flip side of the same coin as the MLA. Whereas the 36 percent rate cap of the MLA does a provably good job of protecting the ability of servicemembers to repay the short-term, small-dollar loans that they take out, we consider the 'ability to repay' provision of the Payday Rule as providing needed protections for veterans, their families and their survivors once servicemembers are out of uniform.

A 2012 report by Pew Charitable Trusts revealed that only 16 percent of payday loan borrowers used them to deal with an unexpected expense, such as a car repair or emergency medical expense. A whopping 69 percent used it to cover a recurring expense, such as utilities, credit card bills, rent or mortgage payments, or food.¹² As we all know, the numbers of Americans living paycheck to paycheck has not declined in the intervening years.

A 2015 Pew article tackles one of the main misconceptions about borrowers who use payday loans: "Many people mistakenly assume that borrowers go to payday lenders because they are 'unbanked,' meaning they're outside the traditional banking system either by choice or by necessity. However, two of the key requirements for obtaining a payday loan are proof of income and a checking account. Thus, these customers, by definition, have to be 'banked.'"¹³ This is the case for many veterans as well, because DoD has required servicemembers to open checking accounts to receive direct deposit payments for several decades.

The 2015 Pew article went on to point out that "the average payday loan borrower is in debt for nearly six months a year and pays an average of \$520 in fees for \$375 in credit."¹⁴ Borrowers who are taking out high-interest, small-dollar loans to meet every day living expenses are ill-equipped to handle such a large, prolonged expense and often resort to repeat borrowing – prolonging the cycle of debt.

One of the main criticisms of the 'ability to repay' provision is that of access to credit: If lenders are forced to make loans only to borrowers who are able to meet more stringent underwriting standards they could go out of business. The resulting dearth of lenders could possibly be more harmful to borrowers, the argument goes.

A 2016 report that found "likely military [payday] borrowers showed increased access to credit card borrowing after the restrictions placed on payday lending by the MLA – credit limits increased by an average of 17-25% on total credit card accounts following passage of the

¹¹ N. Gregory Mankiw, David Romer & Benjamin M Friedman, 2 *New Keynesian Economics*, 305 (1997).

¹² *Payday Lending in America: Who Borrows, Where They Borrow, and Why*, The Pew Charitable Trusts (2012), <https://www.pewtrusts.org/en/research-and-analysis/reports/2012/07/19/who-borrows-where-they-borrow-and-why> (last visited Mar 5, 2019).

¹³ Nick Bourke, *Reforming Payday Loans Begins with Understanding How They Really Work* the Pew Charitable Trusts (2015), <https://www.pewtrusts.org/en/research-and-analysis/articles/2015/12/03/reforming-payday-loans-begins-with-understanding-how-they-really-work> (last visited Mar 5, 2019).

¹⁴ *Ibid.*

MLA.”¹⁵ It is suspected that improved credit scores, largely due to the absence of cyclical, long term, high-interest debt, enabled access to cheaper credit card debt. Even subprime credit card debt is cheaper than many payday loans.¹⁶

Another report noted that usage of Tax Refund Anticipation Loans (RAL) dropped in states where payday lending was capped, which is “apparently a reflection of an interruption in the debt cycle of most former payday borrowers and the improved consumer welfare that follows;” however, pawn shop usage and traditional installment loan usage both saw increases in the wake of payday interest rate caps.¹⁷

Pew noted that after Colorado regulated the payday lending nearly a decade ago some stores closed, while the customer base of other stores grew to accommodate more borrowers, ultimately “serving about the same number of borrowers under the reform legislation but with better outcomes, including more affordable repayments, fewer defaults, and more reasonable loan durations.”¹⁸

This is an important point: neither the ‘ability to repay’ provision in the Payday Rule nor the 36 percent rate cap in the MLA are intended to prevent short term, small-dollar lending and borrowing. Access to credit is a legitimate concern, but as has been noted, 36 percent interest rate caps and more stringent underwriting requirements are more akin to financial pruning of the marketplace, rather than financial clear-cutting or slash and burn farming. VES does not want to end the sale of financial products to low income borrowers; we merely want to ensure that the products that are offered do not result in financial catastrophe for military-connected borrowers.

For these reasons we oppose the Bureau’s proposed revisions to the Payday Rule.

CONSUMERS FIRST ACT

Because of limited knowledge and expertise, VES declines to endorse the bill in its entirety.

However, we welcome and wholeheartedly agree with the provision that contains a Sense of Congress that calls on the “Bureau to immediately resume supervision of its regulated entities for compliance with the Military Lending Act to ensure for the most robust and efficient protection of active-duty servicemembers and their families,” for all of the reasons noted earlier.

¹⁵ Roman Galperin and Kaili Maricio, Tough Times Borrowing: Effects of Fringe Lending Regulation on Credit Standing, Search, and Access, April 2016.

¹⁶ Center for Responsible Lending, Shark Free Waters (2016), 4, <https://www.responsiblelending.org/sites/default/files/nodes/files/research-publication/crl-shark-free-waters-aug2016.pdf> (last visited Mar 5, 2019).

¹⁷ Id, 4-5.

¹⁸ Nick Bourke, Reforming Payday Loans Begins with Understanding How They Really Work the Pew Charitable Trusts (2015), <https://www.pewtrusts.org/en/research-and-analysis/articles/2015/12/03/reforming-payday-loans-begins-with-understanding-how-they-really-work> (last visited Mar 5, 2019).

VES supports the proposed amendments to Section 1013(a)(1) of the Consumer Financial Protection Act of 2010 (12 U.S.C. 5493(a)(1)), which would add a limitation on political appointees at the Bureau.

VES sees this as a way to limit the regulatory uncertainty that has been noted earlier, which has the potential to cause negative impacts on lenders who unintentionally violate the MLA, as well as the recent negative impact on DoD's retention of security clearance holders (and thus national security as a whole), the careers of security clearance holders, and the nation's finances.

VES declines to support the other proposed amendments to Section 1013(a)(1) of the Consumer Financial Protection Act of 2010 (12 U.S.C. 5493(a)(1)), which would give the Bureau a duty to provide adequate staffing, due to a lack of expertise on the issue. We would encourage the Bureau to consider the effect on the servicemembers, veterans, their families and survivors that we serve before making any drastic staffing reductions in the future.

Finally, we support the provision of the Consumers First Act that would create an Office of Students and Young Consumers. Student loan concerns are a surprisingly large issue for both active duty servicemembers and veterans, their family members and survivors, not to mention America as a whole. It has been estimated that over 200,000 servicemembers collectively owe \$1.9 billion in outstanding student loans, and that roughly 25 percent of veterans carry some amount of student loan debt.¹⁹

Establishing this Office would elevate the issues the people that we represent face, particularly in regards to student loan servicers and predatory schools.

Veterans Education Success is grateful for the commitment of the Members of the House Financial Services Committee in supporting our nation's servicemembers, veterans, their families and their survivors.

¹⁹ Mike Saunders, Here Are Some Surprising Ways Troops and Vets Can Cut Their Student Loan Debt, Military Times (2019), <https://rebootcamp.militarytimes.com/veterans/2019/02/19/here-are-some-surprising-ways-troops-and-vets-can-cut-their-student-loan-debt/> (last visited Mar 5, 2019).