

More Scrutiny For Short-Term, Small-Dollar Loans

Law360, New York (July 08, 2013, 12:24 PM ET) -- On June 17, the U.S. Department of Defense issued advance notice of proposed rulemaking (ANPR) related to installment loans used by members of the armed forces and their families.

The rule, which would revise 32 C.F.R. Part 232, comes in the wake of the April 2013 proposed guidance on deposit advance products from the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation, and the Consumer Financial Protection Bureau's April 2013 white paper on payday loans and deposit advance products.

The DOD's interest in installment loans is emblematic of the scrutiny of short-term, small-dollar credit products, which appear to be increasingly vexing to regulators who recognize widespread demand for them but are concerned that such products may create a high-cost borrowing cycle.

The regulation at issue implemented the Talent-Nelson amendment to the John Warner National Defense Authorization Act for Fiscal Year 2007, which established a number of limitations on extensions of credit to covered service members and their dependents, including restrictions on interest, types of security, prepayment penalties, and other terms and conditions of credit. In particular, it imposed a 36 percent annual interest rate cap on vehicle title loans, payday loans and tax refund anticipation loans.

The ANPR invites comments on whether the implementing regulation should be revised, with "special attention" to the definition of "consumer credit." Credit products not currently covered include (1) open-end credit, including credit cards and overdraft lines of credit; (2) debts that can be paid by setoff of deposited funds, including overdraft loans; (3) credit not subject to Truth in Lending Act disclosures; (4) installment loans with terms longer than 91 days; (5) credit secured by a vehicle or other personal property being purchased; and (6) credit secured by a qualified retirement account.

It is clear from the language of the statute that installment loans are directly in Congress's sights. The conference report accompanying the National Defense Authorization Act for Fiscal Year 2013 explains that the Military Lending Act and its implementing amendments have been "largely effective in curbing continuing predatory lending ... to covered borrowers," and specifically calls out "installment loans that target members of the armed forces and their dependents." The conference report cites a report by the

Consumer Federation of America, which asserted without support that many lenders have “modified their products to avoid coverage” by the regulation.

In keeping with the CFPB’s white paper and the proposed guidance from the FDIC and the OCC, the ANPR makes the assumption that short-term, small-dollar lending is frequently predatory. There is no mention of how such loans benefit consumers (many of whom use the products as intended — to bridge temporary financial shortfalls), and whether such benefits may outweigh risks or costs of concern to regulators.

The ANPR requests “examples of alternative programs designed to assist service members who need small-dollar loans.” This will be a significant challenge, and there are no easy alternatives. In fact, installment loans are less costly than bouncing checks, carrying credit card balances, and even most service fees in other industries.

Providers of short-term, small-dollar loan products are bracing for additional regulation on all sides, and the focus on service members raises the stakes. It is worth noting that the CFPB’s recent announcement of enforcement actions against a bank and its service provider in connection with auto financing targeted at service members noted that the DOD and the Judge Advocate General's Corps of each of the service branches provided assistance.

Providers should take steps now to ensure that they are in full compliance with all laws, regulations and regulatory expectations. In light of recent enforcement focus on Unfair, Deceptive And Abusive Practices (UDAAP) in marketing and disclosures, providers should take special care to:

- Review all statements, representations, disclosures and claims relating to costs, fees, value, availability, alternatives, benefits, collection practices, terms and lender identity to ensure clarity, prominence and compliance with regulatory guidance.
- Document carefully all operational procedures, in particular those relating to the processes by which customers select products.
- Establish clear policies and monitoring practices for rollovers, refinancing, seriality or sustained use. Review all marketing materials and communications with consumers to ensure that customers are strongly discouraged from engaging in routine or excessive use.

How the industry will adjust to new rules or regulations remains to be seen. It is clear, however, that if regulators are driven purely by a prevailing view that the use of credit to manage the challenges of cash shortfalls is unwise, service members and all other consumers will be left with reduced access to short-term, small-dollar solutions.

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