



December 18, 2014

The Honorable Charles Hagel
Secretary of Defense
Federal Docket Management System Office
4800 Mark Center Drive
2nd Floor, East Tower
Suite 02G09
Alexandria, VA 22350-3100

Re: Docket Number DOD-2013-OS-0133 Limitations on Terms of Consumer Credit Extended to Service Members and Dependents

Dear Secretary Hagel:

The Office of Advocacy of the U.S. Small Business Administration (Advocacy) submits these comments on the proposed rule on *Limitations on Terms of Consumer Credit Extended to Service Members and Dependents*.¹ Advocacy is concerned that the proposal may impose an undue burden on small entities. Advocacy encourages the Department of Defense (DoD) to reevaluate the certification in the Regulatory Flexibility Act (RFA) section of the proposed rule and to prepare an initial regulatory flexibility analysis (IRFA), if warranted. Advocacy further encourages DoD to consider less burdensome alternatives for small entities.

Advocacy Background

Advocacy was established pursuant to Pub. L. 94-305 to represent the views of small entities before federal agencies and Congress. Advocacy is an independent office within the U.S. Small Business Administration (SBA), so the views expressed by Advocacy do not necessarily reflect the views of the SBA or the Administration. The RFA,² as amended by the Small Business Regulatory Enforcement Fairness Act (SBREFA),³ gives small entities a voice in the rulemaking process. For all rules that are expected to have a significant economic impact on a substantial number of small entities, federal agencies are required by the RFA to assess the impact of the proposed rule on small business and to consider less burdensome alternatives.

¹ 79 Fed. Reg. 58602, September 29, 2014.

² 5 U.S.C. § 601 et seq.

³ Pub. L. 104-121, Title II, 110 Stat. 857 (1996) (codified in various sections of 5 U.S.C. § 601 et seq.).

The Small Business Jobs Act of 2010 requires agencies to give every appropriate consideration to comments provided by Advocacy.⁴ The agency must include, in any explanation or discussion accompanying the final rule's publication in the Federal Register, the agency's response to these written comments submitted by Advocacy on the proposed rule, unless the agency certifies that the public interest is not served by doing so.⁵

The Office of Advocacy performs outreach through roundtables, conference calls and other means to develop its position on important issues such as this one. Advocacy held a conference call with small entities on this issue on November 17, 2014. Advocacy also spoke with other small business stakeholders.

The Proposed Rulemaking

Currently, the Military Lending Act (MLA) rule covers only three types of consumer credit: closed-end payday loans with a term of 91 days or fewer in which the amount financed does not exceed \$2,000; closed-end vehicle title loans with a term of 181 days or fewer, and closed-end tax refund anticipation loans. The MLA rule provides protections to a consumer who is a service member or the dependent of a service member at the time he or she becomes obligated on certain types of consumer credit transactions, such as limiting interest to 36 percent, prohibiting arbitration and prepayment penalties, and requiring delivery of special disclosures before consummation of the transaction (including oral disclosures, which in certain instances may be satisfied by providing a toll-free telephone number the consumer may call to receive the disclosures).

On September 29, 2014, the DoD published in the Federal Register a proposed rule to amend its regulation that implements the MLA. DoD is proposing to amend its existing regulation to extend protections of the MLA to a broader range of products, rather than the limited credit products currently defined as consumer credit. The proposed revisions would limit interest charged to service members and their dependents on all payday loans, vehicle title loans, refund anticipation loans, deposit advance loans, installment loans, unsecured open-end lines of credit, and credit cards. In addition, DoD is proposing to change its existing regulation to amend the provisions governing a tool a creditor may use in assessing whether a consumer is a "covered borrower," modify the disclosures that a creditor must provide to a covered borrower, implement the enforcement provisions of the MLA, as amended, and for other purposes. It would require creditors to screen all applicants against a DoD database before offering such products with rates greater than 36 percent in order to be eligible for a safe harbor. In the RFA section of the preamble, the DoD prepared a certification in lieu of an initial regulatory flexibility analysis (IRFA). Advocacy is concerned about the factual basis for the certification and the requirements for the safe harbor.

DoD's Certification

The RFA requires an agency to prepare an IRFA unless the agency can certify that the rulemaking will not have a significant economic impact on a substantial number of small entities.

⁴ Small Business Jobs Act of 2010 (PL 111-240) § 1601.

⁵ Id.

The certification must be supported by a factual basis. Advocacy questions the reasoning for the factual basis for the certification of this rule.

In the certification, DoD states:

While a substantial portion of firms in each affected market are “small business entities,” Service members and their dependents make up only a small portion of the consumers for those businesses. Because only approximately 2.5 percent of households in the United States include an active duty Service member, the interest-rate limit and other MLA conditions of the proposed regulations would affect a small percentage of the consumers served by the entities that could be creditors covered by this regulation. Thus, the Department concludes that—even though there appears to be a large percentage of small business entities in each affected class of businesses—the proposed regulation would not have a significant economic impact on a substantial number of small businesses because those businesses nonetheless have very few customers who are covered borrowers.⁶

Advocacy asserts that DoD has underestimated the number of entities that may be impacted by this proposal. A major aspect of this proposal is the change in the safe harbor provision of the regulation. As noted above, the current regulations require military members to self-identify as a part of the safe harbor. The safe harbor in the proposal places the onus on the business owner to determine if a credit applicant is a military member or a military dependent by checking the DoD website. In order to benefit from the safe harbor, a business that offers financial credit products that exceed the 36 percent rate would need to check every applicant, not just members of the military and their dependents.

Moreover, the DoD estimates that the proposed rule might impose costs of approximately \$96 million in the first year as creditors adapt their systems to comply with the requirements of MLA and the regulation. After the first year, the annual effect on the economy is expected to be between \$13 million and \$137 million.⁷ However, the DoD does not discuss whether small entities will incur any of the costs in its certification.

The costs associated with this rulemaking should be included in the factual basis of the certification. Advocacy encourages the DoD to perform a threshold analysis to determine the amount of costs that small entities may incur as a result of the proposal and whether those costs amount to a significant economic impact.

Entities regulated by this regulation are those institutions that offer products covered by the statute. Advocacy encourages DoD to assess as nearly as possible how many institutions are therefore covered by this regulation, and to assess as nearly as possible what the cost of this regulation is to each of those entities. If that cost is significant for a substantial number of those entities, Advocacy encourages DoD to publish an IRFA for notice and comment before publishing a final rule.⁸ If the cost is not significant for a substantial number of small entities,

⁶ 79 Fed. Reg. at 58635.

⁷ 79 Fed. Reg. 58602.

⁸ See, Southern Offshore Fishing Association v. Daley, 995 F. Supp.1411 (M.D. Fla. 1998).

Advocacy encourages DoD to provide information sufficient to establish the factual basis for the certification.

New Safe Harbor Provisions May be Burdensome for Small Entities

As noted above, the proposed rule changes the safe harbor provisions. Under the current rule, military members and their families self-identify. Under the proposal, the business must check the DoD website to ascertain whether a borrower is a military member or a military dependent in order to obtain safe harbor protection.

Requiring small entities to check every customer to determine if he or she is a military member or a military dependent could become burdensome. The business may need to train its staff on how to use the DoD website. If the DoD website is not operating, the small entity may lose a non-military customer while it is trying to ascertain whether the customer is a covered borrower.

Although the safe harbor provision is optional, a small entity should not have to forgo the protection of the safe harbor simply because it does not have the financial resources to comply with the new requirements. To mitigate the economic impact on small entities, Advocacy recommends that small entities be allowed to continue to operate under a safe harbor that requires military members and their dependents to self-identify.

Conclusion

Thank you for the opportunity to comment on this important proposal and for your consideration of Advocacy's comments. Advocacy further encourages the DoD to give full consideration to the concerns raised by small entities and their trade associations regarding the proposed rule in order to develop a solution that reaches the agency's goals without being unduly burdensome on small entities. If you have any questions regarding these comments or if Advocacy can be of any assistance, please do not hesitate to contact Jennifer Smith at (202) 205-6943.

Sincerely,

/s/

Winslow Sargeant, Ph.D.
Chief Counsel for Advocacy

/s/

Jennifer A. Smith
Assistant Chief Counsel
for Economic Regulation & Banking

Cc: The Honorable Howard Shelanski, Administrator, OIRA/OMB