

Center for Regulatory Effectiveness

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11 Dupont Circle, N.W.

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February 1, 2007

Via e-mail, FedEx and Facsimile

The Honorable Ben S. Bernanke
Chairman, The Board of Governors
Federal Reserve System
20th Street and Constitution Ave., NW
Washington, DC 20551
202.452.3201

Re: Memorandum of Law on Section 670 of Public Law 109-364, the John Warner National Defense Authorization Act for Fiscal 2007

Dear Chairman Bernanke:

I am writing with respect to a recent congressional action that made DOD a regulator of consumer credit.

Purpose

The purpose of this letter is twofold:

1. Provide you with a *Memorandum of Law*, attached herewith, which demonstrates that the forthcoming DOD *regulation* on predatory lending must regulate all instruments of consumer credit, including direct deposit advances and credit cards.
2. *Request your assistance* in convincing DOD to revise its "Report On Predatory Lending Practices Directed at Members of the Armed Forces and Their Dependents" submitted to Congress so it addresses the totality of consumer credit instruments.

Background

Specifically, Section 670 of Public Law 109-364, the John Warner National Defense Authorization Act for Fiscal 2007, sets terms for extending consumer credit to military personnel and their dependents, and limits the annual equivalent APR on such loans, including service fees and other charges, to 36%.

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Congressional action was in response to DOD's "Report On Predatory Lending Practices Directed at Members of the Armed Forces and Their Dependents" dated August 9, 2006.

The Center for Regulatory Effectiveness (CRE) has analyzed the DOD Report and sought correction because it fails to comply with the Data Quality Act since it:

- (1) Does not define the term "predatory lending," making it impossible to determine the full range of loan products that should have been evaluated in the analysis of predatory lending practices directed at the military; and
- (2) Fails to assess all forms of consumer credit offered to the military, including credit cards, as required by the Report's congressional statutory mandate.

Accordingly, CRE filed a Request For Correction under the Data Quality Act (DQA) in a petition to DOD dated September 21, 2006 and an amendment to that petition of February 1, 2007. In our amendment to the petition CRE forcefully argues that the statute directing the DOD study requires that all instruments of consumer credit, including credit cards, be included in the DOD study; failure to do so will encourage State and local governments to take discriminatory actions at the expense of one product but to the betterment of competing products charging comparable rates of interest.

The Genesis of the Memorandum of Law

Discussions on the DQA petition between CRE and stakeholders, including Executive Branch officials, indicated that CRE should address the scope of Section 670 of Public Law 109-364 and the forthcoming implementing regulation. Specifically, the question to be addressed is whether DOD could legally exempt certain types of consumer loans, such as credit cards, from its implementing regulation.

CRE's position, articulated in the attached Memorandum of Law, is unequivocal. DOD does not have the statutory authority to exempt any consumer loan products, including credit cards and other unsecured loans, from the scope of the regulation other than those the statute itself exempts, *e.g.* mortgages, auto loans, and loans secured by the personal property purchased.

Federal Regulation Of Interest Rates Should Be Non-Discriminatory

CRE believes that federal regulation of consumer interest rates will have significant, adverse impacts and should not be instituted. Yet, if such a regulation is to take effect, all consumer credit products not specifically exempted by the statute must be regulated to: 1) comply with the statute; and 2) avert the federal government from creating unfair, asymmetric competition in the marketplace.

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DOD's report to Congress focused primarily on payday loans, with virtually no mention of other instruments of consumer credit, including direct deposit advances and credit cards.

To illustrate the discriminatory provisions of the DOD report, compare the treatment of payday loans, which were featured most negatively in the DOD Report, with a recent report released by the Federal Reserve Bank of New York (Staff Report No. 273) which states:

“Our findings seem mostly inconsistent with the hypothesis that payday lenders prey on, i.e., lower the welfare of, households with uncertain income or households with less education. ... On the whole, our results seem consistent with the hypothesis that payday lending represents a legitimate increase in the supply of credit, not a contrived increase in credit demand.”¹

Findings such as these by objective third parties make it imperative for DOD to act on the CRE Data Quality petition.

Federal Information Dissemination Needed To Avert Uninformed Decisions By State and Local Governments.

Failure of DOD to:

- (1) Revise its initial report to address the totality of consumer credit instruments, and
- (2) Include all such credit instruments in its forthcoming regulation,

will result in biased and incomplete information being presented to state and local governments who are considering regulatory actions regarding consumer credit limitations. More specifically, if unchecked, DOD publications could result in the over-regulation of products deemed by the Federal Reserve to meet a societal need and no regulation of competing products.

¹ Morgan, Donald P., “Defining and Detecting Predatory Lending,” Federal Reserve Bank of New York Staff Report No. 273, January 2007, pp. 3-4.

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CRE's review of documents available to the public suggests that no substantive consultation was performed by DOD in the preparation of the initial report. That underscores that OMB should take the necessary steps to ensure that substantive co-ordination does take place with respect to the upcoming regulation being drafted by DOD.

Consequently, OMB should invoke its authorities under Executive Order 12866, the Paperwork Reduction Act, and the Data Quality Act to ensure that the congressionally mandated coordination actually occurs in the regulations being developed by DOD.

Requested Actions

DOD

- Revise its initial report to Congress to include all consumer credit instruments.
- Include all consumer credit instruments not specifically excluded by statute in its forthcoming regulation to implement the legislation placing limitations on consumer credit extended to the military and dependents.
- Submit the CRE *Memorandum of Law* to DOJ for comment.

OMB

- Review the CRE Data Quality Petition and the amendment thereto, and work with DOD to revise its report to Congress to address all consumer credit instruments and ensure its accuracy.
- Convene an interagency working group, consisting of DOD, OMB, FRB, OCC, OTS and FDIC to work on the forthcoming DOD regulation on consumer credit limitations.

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Treasury, FRB, OCC, OTS, OCC, and FDIC.

- Review the attached *Memorandum of Law* and communicate their views to OMB and DOD.
- Participate in an interagency *formulation* and review of DOD’s regulation implementing the statute placing limitations on extensions of credit to the military and dependents.

Respectfully,

/s/

Jim Tozzi
Member, Board of Advisors
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February 1, 2007

Via e-mail, FedEx and Facsimile

The Honorable Sheila C. Bair
Chairman, Board of Directors
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429-9990
202.898.6974

Re: Memorandum of Law on Section 670 of Public Law 109-364, the John Warner National Defense Authorization Act for Fiscal 2007

Dear Chairman Bair:

I am writing with respect to a recent congressional action that made DOD a regulator of consumer credit.

Purpose

The purpose of this letter is twofold:

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February 1, 2007

Via e-mail, FedEx and Facsimile

The Honorable John M. Reich
Director
Office of Thrift Supervision
U.S. Department of Treasury
1700 G Street, NW
Washington, DC 20552
202.906.6560

Re: Memorandum of Law on Section 670 of Public Law 109-364, the John Warner National Defense Authorization Act for Fiscal 2007

Dear Director Reich:

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February 1, 2007

Via e-mail, FedEx and Facsimile

The Honorable John C. Dugan
Comptroller of the Currency
Office of Comptroller of the Currency
U.S. Department of Treasury
250 E Street, SW
Washington, DC 20219-0001
202.874.4900

Re: Memorandum of Law on Section 670 of Public Law 109-364, the John Warner National Defense Authorization Act for Fiscal 2007

Dear Comptroller Dugan:

I am writing with respect to a recent congressional action that made DOD a regulator of consumer credit.

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