COMMENTS

of the

Resident Lenders of North Carolina

to

Bureau of Consumer Financial Protection

Consumer Financial Products and Services Offered to Servicemembers

76 Fed. Reg. 54998 (September 6, 2011)
CFPB Docket No. CFPB-2011-0016

Submitted September 20th, 2011

The Resident Lenders of North Carolina (**RLNC**) is submitting this letter in response to the request for comment by the Consumer Financial Protection Bureau on September 6, 2011. Our association of independent consumer finance offices represents a group of traditional installment lending companies that range from one office owner-operators to multi-state operations. With North Carolina home to some of the largest base populations of military personnel and their families in the country, we appreciate the opportunity to respond to the CFPB's notice and request for comment on consumer financial products and services offered to servicemembers and their families. This response is primarily directed to the following question:

1. What consumer financial products and service are currently offered to or utilized by service members and their families?

North Carolina Traditional Installment Loan Lenders

North Carolina has a highly regulated consumer finance small dollar installment loan industry that has been routinely supervised through the North Carolina Commissioner of Banks office since 1945. In addition to the regulatory oversight from the state, consumer finance offices offering traditional installment loans are subject to extensive federal regulations such as the Fair Credit Reporting Act, Red Flag Requirements, The Fair Debt Collection Practices Act, and the Truth in Lending Act.

In addition to meeting the requirements set forth in Federal laws, North Carolina consumer loan offices offer traditional installment loans through the regulatory guidelines set forth in North Carolina's Consumer Finance Act. Originally enacted in 1961, North Carolina's small loan law joined the progression of other state laws which since the early 1900's sought to establish a safe and accessible small dollar credit option for consumers. The establishment of these laws was due to a recognition that in order to have legitimate businesses operating this service, there needed to be a "carve out" of the existing usury limitations in order to allow for a reasonable return for the business. At that time, the early 1900's, it was noted that the rate should be between 2% to 3% per month (24% to 36% annually). The creation of these laws is credited with driving out illegal loan sharking and bringing a much needed service under the watchful guidance of state regulations and supervision.

It was the very features of the traditional installment loan, including safety, responsibility, and reasonable pricing for the product offered, that led to its acknowledgement in the 2007 DOD predatory guidelines of being a beneficial service to military personnel and its exemption from the 36% Military APR limitation. As the DOD report stated:

"Isolating detrimental credit products without impeding the availability of favorable installment loans was of central concern in developing regulation. Consequently, installment loans that do not fit the definition of 'consumer credit' in Section 232.3(b)…are not covered by the regulation."

That policy's objective was to target those forms of demonstrable harmful credit without limiting the more responsible forms of small dollar loans. It has been the traditional installment loans that have been assisting service personnel with their credit needs for many decades in both a safe and responsible manner. The traditional installment loan easily exceeds the standards required by the Department of Defense for preventing abusive lending and delivering a beneficial, but disciplined service that helps promote personal financial stability.

Serving Military Personnel

Providing responsible and safe small dollar credit along with understanding and working with consumer's circumstances are important components of any successful consumer loan transaction. This is especially critical with the men and women of the United States Armed Services who by virtue of their responsibilities are often placed in harm's way defending our country. Here in North Carolina, that philosophy is paramount given the significant presence of military bases in the state. North Carolina is home to the third largest military population in the United States. The military presence in North Carolina includes:

Fort Bragg - One of the largest and busiest military complexes in the world, Ft Bragg is home to almost 10 percent of the Army's active component forces and approximately 43,000 military personnel and their families.

Camp Lejeune - There are several major Marine Corps commands and one Navy command aboard Camp Lejeune and is home to more than 47,000 Marine and Sailors from around the world.

Cherry Point Naval Depot - Cherry Point is home to the 2nd Marine Aircraft Wing and several other tenant units.

Seymour Johnson AFB Units - Seymour Johnson Air Force Base is a major Air Combat Command, home to over 6,400 military members.

Key features of North Carolina's traditional installment loans used by servicemembers are:

- **Full disclosure of loan terms and existing Federal APR requirements in simple and transparent language.**
- **Appropriate upfront underwriting of credit risk and repayment ability.**
- **Repayment terms that are appropriately budgeted to maximize success for the borrower thus preventing potential financial distress.**

Overall, traditional installment loans made under the guidance of North Carolina's Consumer Finance Act are used by an estimated 10% of the state's population. In recent surveys though, less than 2.5% of the estimated 375,000 loans outstanding were to military personnel. This lower usage rate may be associated with a higher balance range for servicemembers with credit cards than the general population and a lack of familiarity of the traditional installment loan benefit.

Of utmost importance concerning consumer credit to servicemembers is ensuring that loans are safe, affordable to ones budget, and that they responsibly managed debt in order to minimize any potential financial distress in the future. Financial distress is often cited as a major concern due to the detrimental consequences it can create on the servicemember, their family, or on carrying out their military responsibilities. The latter having consequences not only to the servicemember, but to those serving along side in difficult and challenging situations.

Traditional Loans are Both High Quality & Transparent.

Throughout the discussion and debate concerning the need to ensure that service members are not placed in an "unsustainable" debt trap, a constant theme is heard concerning the need for small dollar credit and the importance of responsible lending. What can really place consumers in a position of financial distress is a lack of safe, reasonably priced credit options. Many of the nation's leading consumer advocates point to the need to have "high quality" small dollar credit available to consumers. The need for small dollar credit, and the important features it must provide, has been the main concerns of the Center for Financial Services Innovation, one of the country's leading advocacy and research organizations for the unbanked and under-banked.

Recently in an article in the American Banker, Jennifer Tescher, Director of the CFSI stated:

"However, income supports, budgeting guidance and additional savings will not entirely fill the need that credit satisfies. Well-structured credit can help build a credit history; facilitate an investment or purchase that provides the foundation for the other wealth-building activities; and support a household's ability to save.

To meet these goals, small-dollar credit must be high-quality. It must be marketed transparently. It must be affordable and structured to support repayment, with amortization periods that extend beyond a single pay period, and repayment must be reported to the credit bureaus.

Ideally, it may also be accompanied by other features, such as savings accounts or budgeting advice that can prepare the borrower for greater financial prosperity over time. However, the additional complexity created by such features must be balanced against the convenience, speed and privacy that consumers demand and the additional costs they create for the lender."

Traditional installment loans, such as those offered in North Carolina under the Consumer Finance Act, provide those features that are required to be "high quality" thus ensuring the maximum opportunity to be a successful consumer credit service for military personnel and their families. These features include:

- **Fully amortized loan terms.**
- **Minimum term of six months.**
- **Equal monthly payments.**
- **Fixed interest rates.**
- **Fully disclosed terms in simple and transparent language.**
- **Convenience with a quick turnaround (< 24 hours).**
- **Privacy**
- **Reporting to Credit Agencies.**

As noted in the North Carolina Commissioner of Bank's 2001 study:

"CFSI identifies the following advantages of the installment lending business model: Larger loans; longer terms; fixed rate; equal repayments; loan data reported to major credit bureaus; and direct interaction. To this list, we would add transparency and stability of lending terms.

The product offered by North Carolina's consumer finance companies, which is strictly prescribed by the CFA, offers these advantages."

"Perhaps the most distinguishing feature of the consumer installment business is its traditional, high touch, high cost business model. Just as they have for decades, NC Consumer Finance companies operate using a monoline store-front model."

It is these very features that differentiate traditional installment loans provided for in North Carolina from the predatory financial loan products and practices identified in the DOD regulations issued in 2007. The customary terms and conditions of this disciplined consumer credit have demonstrated consistently that accessing traditional installment loans helps to minimize the possibility of a servicemember or their family member from falling into financial distress.

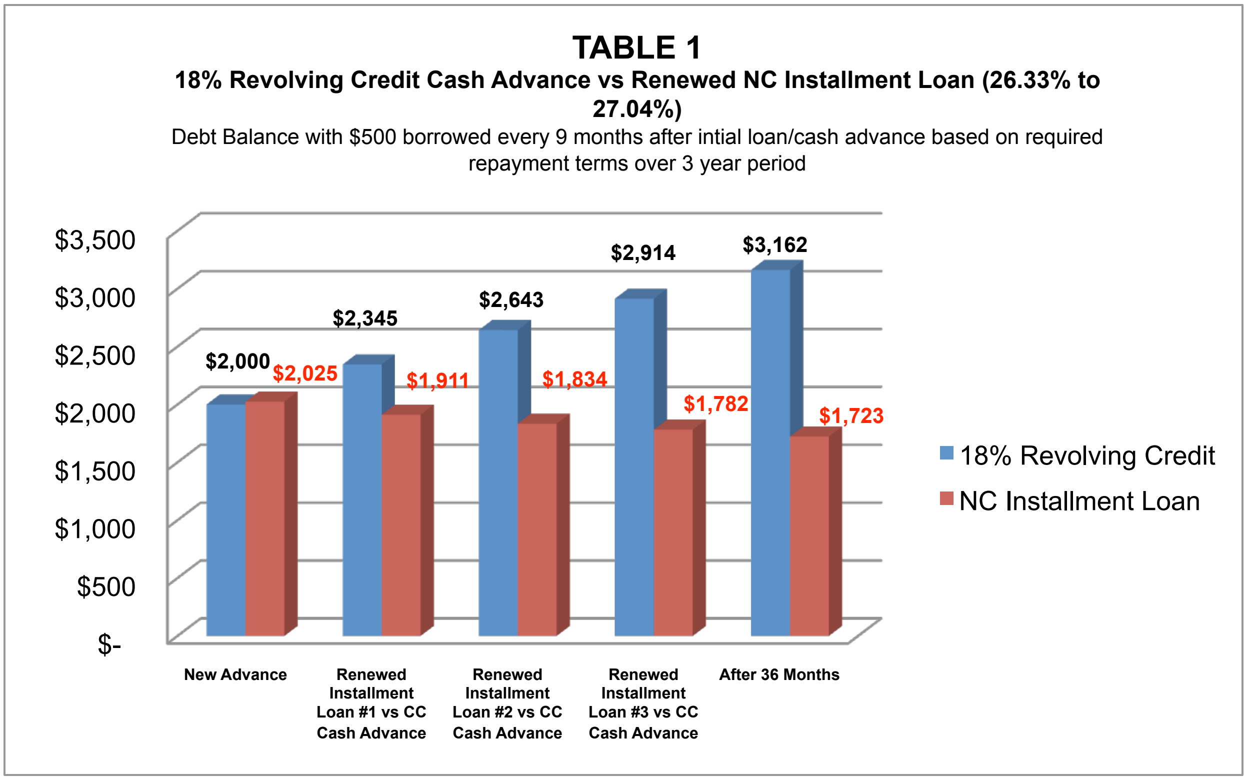
As noted in the North Carolina Commissioner of Bank's 2011 study:

"For that group of borrowers who do not neatly qualify under automated underwriting models, finance companies offer traditional, case-by-case underwriting. They look at credit reports, but often disregard credit scores, instead looking more closely at particular lines. Underwriting places heavy emphasis on analyzing ability to repay, and closely examines income and employment."

Traditional Installment Loans Prevent the "Cycle of Debt"

Unlike short-term credit products which typically have a maturity date of 90 days or less, along with a balloon payment at the end that is often difficult for borrower's to meet and thereby necessitating the need to "refinance", traditional installment loans are structured for an amortized payout that fits within the borrowers budget. This means that the debt obligation is reduced on a more disciplined repayment schedule and will ensure that a borrower's debt will not become "stagnant" or build up over time due to minimal principal payments.

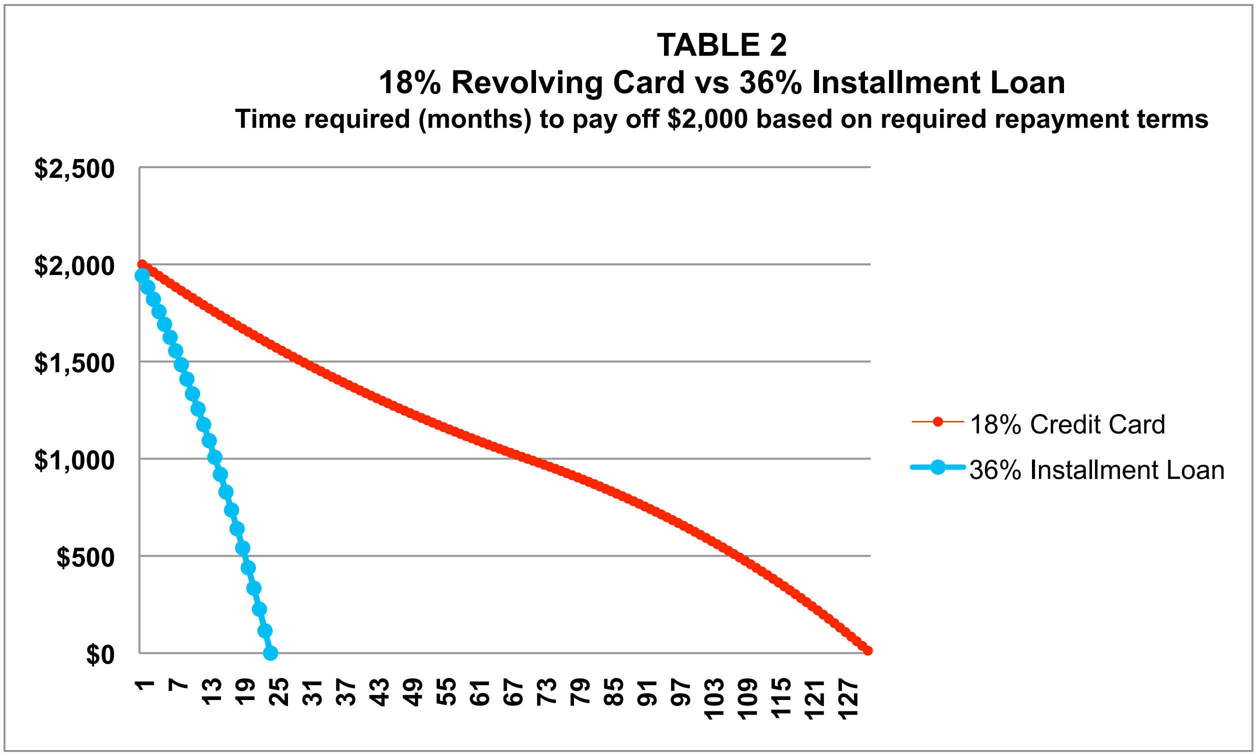
Traditional installment loans also do not provide for "instant re-borrowing". Consumers must re-apply for new credit which requires a new underwriting to be performed based on the same guidelines of the original debt. This ensures that additional credit needs are measured properly with respect to the borrower's ability to successfully repay the new obligation.



In **TABLE 1**, a typical $2,000 installment loan has an estimated monthly payment of between $109 (the first loan) and $97 (the third renewal). The typical revolving credit product has a minimum repayment of between 1% and 3.5% of the balance due. The average repayment during the 36 month for the revolving credit is $60 based on the monthly balance due.

Traditional installment loans also have a more "aggressive" debt repayment schedule than what is required with revolving credit. Traditional installment loan amortized payments typically run from 5% to 10% of the principal borrowed for larger dollar/longer term to 15% to 20% for smaller dollar/short terms.

In **TABLE 2**, we can see how a 36% fixed payment traditional installment loan can retire debt significantly faster than an 18% revolving credit will with the minimum repayment features. And while a borrower can make the same payments on the 18% revolving account as the fixed payment installment loan, current market evidence points to a lack of discipline on revolving account debt holders with a majority of revolving accounts carrying a balance each month. And in recent surveys, servicemembers are carrying a higher revolving account balance on their credit cards than the civilian population in general. While revolving accounts clearly offer benefits to servicemembers such as convenience, ease of use, a flexible payment options, and in most cases, a lower APR, they still present a financial challenge to some, especially younger servicemembers, with respect to debt repayment discipline.



As indicated in the North Carolina Consumer Finance Annual Report, a large number of loan transactions conducted each year are with existing customers. Under the North Carolina Consumer Finance Act, borrowers are only allowed to have one loan with a licensee. Traditional installment loans do not allow "instant access" to new borrowings but instead require that the borrower resubmit a new request and complete a new underwriting process. With this in mind, a consumer who has an additional credit need would have to "reapply" and qualify for the new credit. This request would include both the remaining balance of the previous loan and any new money advanced.

In fact, the North Carolina Commissioner of Banks stated in his cover letter accompanying his 2011 report to the State's General Assembly that repeated claims of harm from "refinancing" were unfounded and that neither the state or consumer advocates who participated in the study could provide any compelling evidence to the contrary. According to the Attorney General of North Carolina's Office of Consumer Protection, there were only 245* complaints filed in a three year period between 2008 and 2010 on over 1,000,000 loan transactions made. The Commissioner of Banks also performs consumer surveys of North Carolina's financial services and Consumer Finance Act licensees consistently rate in excess of 85% of respondents being either somewhat or very satisfied.

*** The NCCOB report indicates that a portion of these complaints were related to Sales Finance transactions and are not part of the NC Consumer Finance Act loan activity.**

How Installment Loans are Underwritten Matters.

Not all loans being identified as "installment loans" are the same. Some forms of **short-term credit** (loans less than 90 days with balloon payments) are now being marketed or identified by these lenders as installment loans, though they clearly are not. They do not have the same guidelines as required by the NC CFA or the important features identified by both a leading consumer advocacy group and the recent study performed by North Carolina's Commissioner of Banks in February 2011 when it comes to safe and reasonably priced small dollar credit. Unfortunately, this has led some consumer advocacy groups who oppose this form of lending to associate the term "installment loan" when describing the short-term credit products that were the focus of the DOD's predatory lending policy. By doing so, they have incorrectly identified payday and title loans as such, thereby inappropriately implying that traditional installment loans carry the same features and characteristics, when clearly they do not.

<u>Recent North Carolina Legislative Action</u>

The harmful consequences from this confusion of inaccurately labeling short-term credit products like payday and title loans as "installment loans" becomes evident anytime there are discussions on how best to protect servicemembers from DOD defined predatory practices. Important legislative considerations in protecting this safe and disciplined credit option to consumers, and more importantly, military personnel and their families was a recent issue in the state of North Carolina 2011 legislative session.

Legislation introduced in April of this year to update North Carolina's Consumer Finance Act, last addressed in 1983, was met with fierce resistance by North Carolina based consumer advocacy groups who have historically opposed any action that they considered to be beneficial to the industry, regardless of its merits or the necessity of appropriate actions required to keep a proven safe credit option available to consumers. During the legislative process, representatives from several military commands weighed in on the debate, expressing concerns and objections about North Carolina's CFA installment loans and the proposed changes being contemplated.

A careful review of the issues raised by some military representatives in May and June of this year concerning both existing lending practices and the proposed legislation appear to have been influenced by this mischaracterization of what defines an installment loan and what defines a short-term loan. Criticisms of installment loan lending by North Carolina CFA licensees and the proposed legislation appear to be more closely attributed to the very products targeted by the DOD's predatory guidelines and not with traditional installment loans. This was reinforced by Joe Smith, Commissioner of Banks, who stated in his final comments of the 2011 report:

"The existing evidence and items brought forward at the study group sessions provided no basis to believe that borrowers are being systematically harmed by consumer finance companies."

Other forms of harmful financial transactions to servicemembers have been associated with the selling of consumer products at materially inflated prices and then financing the purchase through an installment loan. Recently, a retail chain operating stores outside of military installations was placed off-limits by base commanders due to their practice of selling consumer electronic products at prices significantly higher than market retail prices and then financing the purchase through their own installment loan process. Attorney Generals from New York, Tennessee, and Kentucky have taken action against this store chain and obtained compensation for servicemembers in addition to closing down their sales operations. Under North Carolina's Consumer Finance Act, small loan licensees are not allowed to conduct a retail merchandise operation in their store fronts.

Reasonable Cost

The below **Rate Chart** has been constructed to identify the dollar costs in both monthly repayment and total payments, along with the computed annualized APR, for a six month, $500 loan that would be fully amortized.

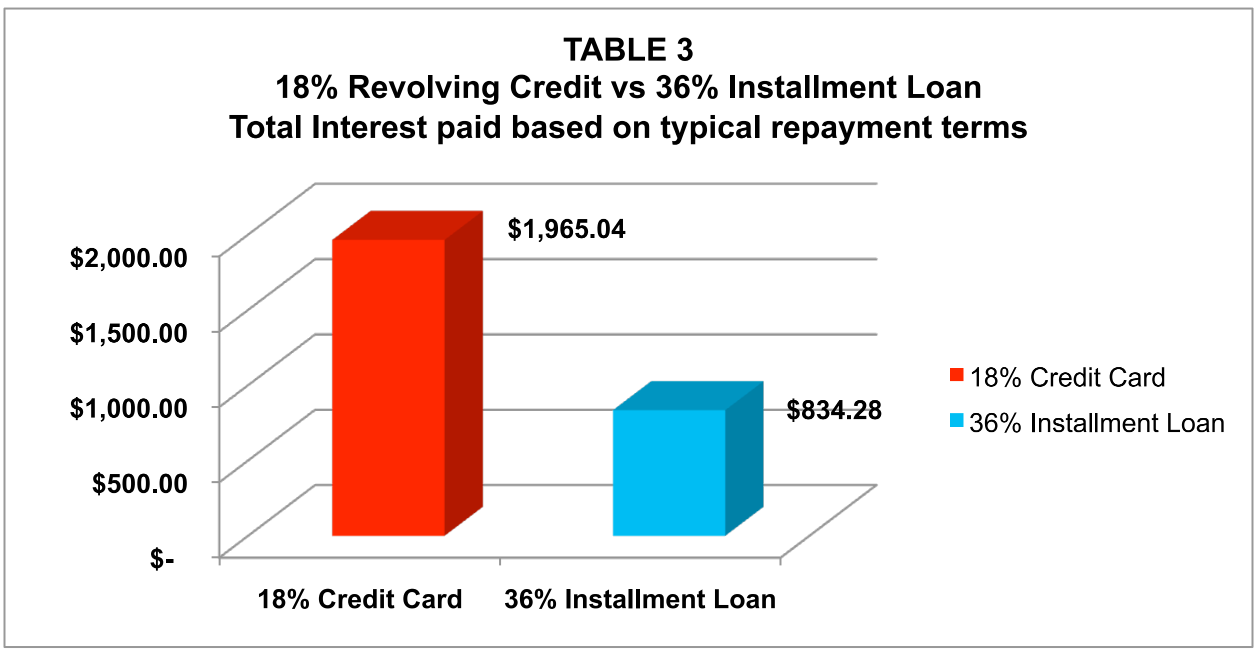
	Loan Fee	**Monthly Payment**	**APR**	**Total Payment**
12%	$0	$86.27	12.00%	$517.62
18% (1) **Standard Credit Card Cash Advance Rate & Fee**	$15 **Cash Advance Fee.**	$91.94(4)	34.59% **Does not take into consideration annual fee**	$551.64
28% (2) **2011 National Credit Union Administration Small Loan Guideline**	$20.00 **May be charged three times a year**	$93.88	42.18%	$563.28
30% **Existing North Carolina CFA Rate under 53-176(3)**	$25.00 **May be charged twice a year**	$95.31	47.73%	$571.86
36% **FDIC guidelines for the Small Dollar Loan pilot**	$0	$92.30	36.00% (5)	$553.80

(1) Loan is calculated under compounding interest.
(2) Loans are calculated under simple interest.
(3) Under 53-176, interest is computed at 30% on the first $1,000 and 18% of each dollar thereafter for a blended rate up to $7,500. Any loan > $7,500 is computed at an 18% on the entire balance. North Carolina CFA allows an interest rate of 36% up to $600 under a 53-173 license. There are only 6 licensees operating under this law and none are located within a 25 mile radius of any military installations. An industry sponsored survey indicated that none of these offices had loans to active duty military personnel under this license.
(4) Under the standard repayment requirements, monthly payments would be the greater of 2.5% of the balance or $25. This would result in a monthly payment of $25 and a repayment term of 25 months resulting in a total payment of $620.36.
(5) FDIC pilot maximum APR rate

A High APR Does Not Imply High Cost to Consumers

APR (Annual Percentage Rate) was implemented specifically to ensure that the same methodology for calculating a loan's APR was used consistently by all financial service providers. This way a consumer could reliably determine the comparative charges between varying loan options. APR was never intended to be a determinate of the reasonableness of the loans cost to consumers, especially for smaller dollar credits. And when small dollar loan repayment terms are less than one year, the annualized APR calculation can balloon even though the actual dollar costs amounts for the credit are relatively small.

As indicated in the **Rate Chart** on page 9, the dollar difference between an 18% credit card cash advance with a $15 fee and North Carolina's current CFA scheduled rate of 30% with a $25 fee is only $3.37 a month. Yet the computed APR comes to 34.59% for the credit card and 47.73% for the NC installment loan. While the 47.73% computed APR can give a false impression that there is an excessive charge to the loan, the total cost to the consumer is less than $12 a month for the six month term. As **TABLE 3** indicates, repayment terms can make a big difference in what a consumer ultimately pays in interest. In this case, a 36% installment loan can cost significantly less than an 18% revolving credit card debt based on required repayment terms.



This was an important point brought out by Jennifer Tescher of the Center for Financial Services Innovation in her letter to the FDIC concerning their small-dollar loan pilot program and the need to not let the actual dollar cost for the service get overshadowed:

"Double-digit interest rates in excess of 36 percent APR can provoke community outrage, yet over the course of a month, what may seem like an overly high interest rate may only generate a relatively small cost to the consumer."

The challenge in limiting the primary determining factor of a credit product's worthiness and benefit to a consumer based solely on its APR is that the beneficial credit characteristics of the traditional installment loans will be lost. This will ultimately lead to a destructive scenario in which historically safe and responsible credit options for consumers will diminish and that will ultimately lead to increases in financial distress. This is because the economic fundamentals of providing a safe and responsible small dollar loan are based on dollars, not an APR. If a provider of these services cannot generate sufficient dollars to cover expenses and earn a reasonable rate of return, then there will be fewer options and that is never in the best interest of consumers.

A recent survey presented to North Carolina legislators during a 2010 Joint Legislative Study Commission on the Modernization of North Carolina Banking Laws and the Consumer Finance Act observed that the operational costs of managing a consumer finance operation in North Carolina was very high. This observation was also noted by most of the bank's participating in the FDIC's small dollar loan pilot program. The survey, prepared by a nationally known accounting firm showed that the average branch cost per loan for a North Carolina licensee was between $250 and $300 before bad debt and interest expense.

The higher costs associated with providing safe and responsible small dollar loans was evident with the FDIC's small-dollar pilot participants who even with a 36% APR, could not achieve a measurable level of profitability. In fact, most participants indicated that offering the individual product was unprofitable.

Since the implementation of the small-loan credit laws in the early 1900's, through today, policy makers and industry observers have recognized that if legitimate for-profit lending operations, operating under the watchful eyes of sound regulatory policy, cannot make a return on their investment, there will fewer safe options available. By limiting reasonable and affordable choices, servicemembers will be placed in a higher level of stress as their options begin to be narrowed to less desirable solutions. This includes, but is not limited to:

1. Having to do without, regardless of the consequences to themselves or their family.

2. Seeking out lending sources that are either unregulated or illegal.

3. Having to sell or pawn personal items or valuables for pennies on the dollar.

4. Having to incur additional expenses above and beyond what a small dollar loan would have cost.

5. Having to seek charity or assistance from families, many who cannot afford to even if they wanted to help.

Summary

While reform and regulation of the financial industry have been in the forefront of public debate recently, the effort to promote strong consumer protection is not best served by limiting or denying access to responsible, affordable, and disciplined credit products. Given the current economic conditions and recent changes to credit card regulations, the need for small dollar credit through responsible lending is more important than ever, especially for our nation's military members and their families.

This is because what really causes financial distress for consumers is a lack of reasonably priced credit options that are underwritten for success. That success is based on a loan that fits the borrower's budget, that follows an appropriate debt repayment schedule, and that is transparent and straightforward with no tricks or traps.

We, the Resident Lenders of North Carolina, have always strongly supported these safeguards as responsible business owners and responsible lenders. The high touch, one on one transactional relationship that is the basis of a traditional installment loan ensures that consumer protection remains at the forefront. With respect to the consumer finance loan relationship, the business succeeds only if the consumer succeeds. For military personnel and their families, the traditional installment loan, like those offered in North Carolina, has continued to be one of the safest, most disciplined, and responsible forms of credit available. Its continued access, as determined by the DOD's statements in the 2007 Predatory Policy guideline, is more important than ever.