UNITED STATES OF AMERICA
Federal Trade Commission
WASHINGTON, D.C. 20580

Office of Commissioner Joshua D. Wright

December 26, 2014

Via Electronic Delivery to the Federal eRulemaking Portal at
http://www.regulations.gov

Federal Docket Management System Office
4800 Mark Center Drive
2nd Floor, East Tower, Suite 02G09
Alexander, VA 22350-3100

Re: In the Matter of Request for Comment on Proposed Revised Regulation Regarding Limitations on Terms of Consumer Credit Extended to Service Members and Dependents; Docket No. DOD-2013-OS-0133

Dear Sir or Madam:

This comment is respectfully submitted in response to the call for comments on proposed amendments to the Department of Defense's (DoD) regulation implementing the Military Lending Act ("MLA") set forth in its September 2014 Notice of Proposed Rulemaking ("NPRM").[1] I provide this comment in my capacity as a Commissioner of the Federal Trade Commission,[2] to which I was sworn in on January 11, 2013, to a term that expires in September 2019.[3]

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[1] John Warner National Defense Authorization Act for Fiscal Year 2007, Pub. L. 109-364, as amended by the National Defense Authorization Act for Fiscal Year 2013, Pub. L. 112-239, codified in 10 U.S.C. § 987. The existing DoD regulation is at 32 C.F.R. Part 232 (hereinafter "existing regulation"); the proposed amendments are at 79 Fed. Reg. 58602 (Sept. 29, 2014) (to be codified at 32 C.F.R. Part 232) (hereinafter "proposed regulation").

[2] The views expressed here are my own and do not necessarily represent the views of the Federal Trade Commission or of any other Commissioner.

[3] Prior to joining the Commission, I was a professor at George Mason University School of Law and held a courtesy appointment in the Department of Economics. As an academic, I have published more than 70 articles and book chapters, co-authored a casebook, and edited several book volumes focusing upon economics, antitrust law, and consumer protection, including several focusing upon the law and economics of consumer credit and its regulation. *See, e.g.*, David S. Evans & Joshua D. Wright, The Effect of the Consumer Financial Protection Act of 2009 on Consumer Credit, 22 Loyola Consumer Law Review 277 (2010); Joshua D. Wright & Todd Zywicki, Three Problematic Truths About the Consumer Financial Protection Agency Act of 2009, Lombard Street, Vol. 1, No. 12 (September 14, 2009);

I support the goals behind DOD's efforts to implement strong consumer protections for service members. Because changes to the MLA are likely to have a significant impact on credit availability for service members in terms of the quantity, quality, variety, and prices of consumer credit, it is important to fully consider the full economic costs and benefits of any such change. This comment is intended to highlight some of the pertinent economic work on the economic impact of regulation restricting the availability of consumer credit which should inform attempts to craft any amendments to the MLA, but in particular, the proposed amendment expanding the existing regulation to cover a broader range of closed-end and open-end credit products.[4]

DoD tailored the scope of the MLA's coverage with the economic consequences of regulation restricting the availability of consumer credit in mind, and acknowledging the potential for more broadly applicable regulation to "adversely affect credit availability."[5] DoD's sensitivity to the potential unintended consequences and unknown impact of broader resrtictions upon the availability of consumer credit are also evident in its efforts to obtain and analyze additional data regarding the nature, scope, and prevalence of credit products offered or extended to service members and their families, as well as the consumer impact of those proposed changes.[6]

The economic consequences of regulation restricting access to consumer credit are well-documented and have been the subject of rigorous research and investigation. Much of the economic literature focuses upon the economic consequences of usury laws and rate caps on

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Joshua D. Wright, The Antitrust/Consumer Protection Paradox: Two Policies at War with Each Other, 121 Yale L.J. 2216 (2012); and Joshua D. Wright, Behavioral Law and Economics, Paternalism, and Consumer Contracts: An Empirical Perspective, NYU Journal of Law & Liberty 470 (2007). I also served as Co-Editor of the *Supreme Court Economic Review* and a Senior Editor of the *Antitrust Law Journal*. I received a J.D. from UCLA in 2002, a Ph.D. in economics from UCLA in 2003, and graduated with honors from the University of California, San Diego in 1998.

[4] *See* proposed 32 C.F.R. § 232.3(f); 79 Fed. Reg. at 58602.

[5] 72 Fed. Reg. at 50580, 50584.

[6] *See* 79 Fed. Reg. at 58606, 58631.

specific consumer credit products, including credit cards. Other recent studies focus upon alternative credit products such payday loans, auto-title loans, and other products that might be covered under a broadened MLA. Any decision to restrict or to expand consumer access to credit, including alternative forms of credit, ought to fully consider both any potential benefits and costs to consumers of those changes. While not intended to provide an exhaustive view of the relevant economic literature focusing upon the consequences to consumers of regulation restricting access to various forms of credit, it is my view that totality of the evidence strongly suggests that further restrictions may cause serious harm to service members.

The simplest and most common restriction on upon access to consumer credit is a usury law – that is, a rate cap imposed upon a specific credit product. Usury laws have been the subject of considerable research.[7] Economists have documented several economic effects from usury regulations. First, there is no evidence that usury restrictions actually reduce the equilibrium price of consumer credit, which is set by the forces of supply and demand.[8] Restricting interest rates, therefore, often merely redirects changes in prices to other terms of the contract, such as downpayments, up-front fees, or loan maturities.[9] Decades of economic research finds that an inevitable result of interest rate ceilings is to restrict access to legal credit for consumers, especially higher-risk borrowers.[10] On the other hand, restricting the supply of credit does not eliminate

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[7] For a summary of research regarding the history and economic effects of usury regulations, *see* Gregory Elliehausen, Thomas A. Durkin, Michael Staten, & Todd Zywicki, Consumer Credit and the American Economy 482-519 (2014).

[8] *Id.* at 518.

[9] *Id.* at 515-16.

[10] *See, e.g.*, Diane Ellis, The Effect of Consumer Interest Rate Deregulation on Credit Card Volumes, Charge-Offs, and the Personal Bankruptcy Rate, FDIC Bank Trends 98-05 (1988) (showing deregulation of credit card usury ceilings after 1978 produced a substantial increase in credit card availability); Daniel Villegas, The Impact of Usury Ceilings on Consumer Credit, 56 (1) Southern Economic Journal 126 (1989) (finding the quantity of consumer revolving and non-mortgage closed-end credit was significantly lower in states with usury ceilings during the year 1983); John Wolken & Frank Navratil, The Economic Impact of the Federal Credit Union Usury Ceiling, 36(5) Journal of Finance 1157 (1981) (finding that loan growth in federally chartered credit unions was constrained by the imposition of usury ceilings during

consumer demand for credit: thus, stricter interest rate ceilings imposed upon consumer credit have been associated with a growth of illegal loan sharking operations, often provided by organized crime. For example, a 1968 Senate Report concluded that loan-sharking was the second largest revenue source of the mafia at that time.[11] Finally, by segmenting credit markets and making product pricing more complex and less transparent, usury restrictions may actually lead to higher prices for consumers than would otherwise prevail.[12]

The fundamental policy question is whether usury laws and other restrictions on access to consumer credit are good or bad for consumers. In theory, usury laws could restrict access to credit, which would in turn prevent borrowers from alleviating hardships by managing consumption over time. That is, credit availability in the short-term might enable a household that receives a negative shock to income to avoid adverse events like foregone health care, eviction, or delinquency on debt. Alternatively, if consumers systematically err weighing the costs and benefits of taking on additional debt today, it is possible that restricting consumer access to credit could improve consumer outcomes. Of course, restricting access to one form of credit, or rationing its use, will also predictably result in those consumers turning to other, perhaps higher-risk, forms of credit.

Economic research has overwhelmingly concluded that usury ceilings generally harm those that they are intended to help.[13] As Nobel Laureate Paul Samuelson testified before the

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the late 1970s). *See also* Oren Rigbi, The Effects of Usury Laws: Evidence from the Online Loan Market, 95 (4) Review of Economics and Statistics 1238 (2013) (finding that an increase in the usury ceiling covering unsecured consumer installment loans between 2007 and 2008 expanded this type of credit, especially among risky borrowers).

[11] U.S. Senate, Committee on Government Operations, Subcommittee on Legal and Monetary Affairs, Federal Effort Against Organized Crime: Report of Agency Operations (June 1968).

[12] Durkin, *et al.*, *supra* note 7 at 515.

[13] One recent study evaluates these overall effects by examining the causes and consequences of usury laws in the United States during the 19th century. *See* Efraim Benmelech & Tobias J. Moskowitz, The Political Economy of Financial Regulation: Evidence from U.S. State Usury Laws in the 19th Century, 65 Journal of Finance 1029 (2010). Benmelech and Moskowitz find that usury laws not only lead to less credit, but also that a one percentage point lower rate ceiling results in approximately 4 to 6 percent less economic growth over the next decade. The authors also find

Massachusetts State Legislature in 1969, "The concern for the consumer and for the less affluent is well taken. But often it has been expressed in a form that has done the consumer more harm than good. For fifty years the Russell Sage Foundation and others have demonstrated that setting too low ceilings on small loan interest rates will result in drying up legitimate funds to the poor who need it most and will send them into the hands of the illegal loan sharks. History is replete with cases where loan sharks have lobbied in legislatures for unrealistic minimum rates, knowing that such meaningless ceilings would permit them to charge much higher rates."[14] Moreover, by drying up the supply of credit available to riskier (often lower-income borrowers) and redirecting supply to lower-risk borrowers, economists have also found that usury regulations can have regressive redistributive effects of benefiting higher-income consumers at the expense of lower-income consumers.[15] Further, restrictions upon access to consumer credit are often the manifestation of anticompetitive motives – that is, because "incumbents with political power prefer stringent usury laws because they impede competition from potential new entrants who are credit rationed."[16]

There is also a large and growing empirical literature on the effects of access to what might be considered alternative or especially high-risk credit on consumers. The evidence here is somewhat mixed. For example, several studies have found that access to payday loans and other

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that this reduction in economic growth comes largely at the expense of small firms; large firms are able to evade the restrictions and find alternative sources of credit. This finding is consistent with evidence that the democratization of credit in the United States has generally resulted in large benefits for traditionally disadvantaged groups. *See* David S. Evans & Joshua D. Wright, The Effect of the Consumer Financial Protection Act of 2009 on Consumer Credit, 22 Loyola Consumer Law Review 288 (describing a number of innovations that significantly reduced liquidity constraints, enabling more Americans to borrow more and helped increase credit availability dramatically for members of socially and economically disadvantaged groups).

[14] Paul Samuelson, Testimony Before the Massachusetts State Legislature Judiciary Committee on the Uniform Consumer Credit Code (January 29, 1969).

[15] Durkin, *et al.*, *supra* note 7, at 533-36.

[16] Benmelech & Moskowitz, *supra* note 13, at 1071.

forms of alternative lending exacerbate financial distress for at least some consumers.[17] However, there is also ample evidence that restrictions upon access to consumer credit – including payday loans and other alternative lending products – can have serious negative consequences for consumers. For example, studies find that, on average, access to payday loans and other products help consumers smooth negative expenditure shocks, avoid more onerous forms of credit, alleviate financial distress, and increase job retention.[18] The evidence suggests that some consumers will face adverse consequences if these forms of credit are restricted.[19] Policymakers must carefully weigh the costs and benefits of further restrictions before implementing them in order to ensure that the costs to consumers, service members in this instance, do not outweigh any benefits.

The DoD's proposed rule is especially susceptible to unintended consequences that may outweigh any potential benefits to service members. Most notably, the DoD proposal excludes bank overdraft protection from its regulatory scope, yet researchers have consistently found that overdraft protection is a close substitute for payday lending for consumers.[20] Eliminating access to

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[17] Dennis Campbell, Francisco de Asis Martinez-Jerez & Peter Tufano, Bouncing Out of the Banking System: An Empirical Analysis of Involuntary Bank Account Closures, Working Paper, Harvard University (December 3, 2008); Paige Marta Skiba & Jeremy Tobacman, Do Payday Loans Cause Bankruptcy?, Vanderbilt Law and Economics Research Paper No. 11-13 (November 9, 2009); Brian T. Melzer, The Real Costs of Credit Access: Evidence from the Payday Lending Market, The Quarterly Journal of Economics (2011) 126 (1): 517-555.

[18] Scott Carrell & Jonathan Zinman, In Harm's Way? Payday Loan Access and Military Personnel Performance, The Review of Financial Studies (2014); Jonathan Zinman, Restricting Consumer Credit Access: Household Survey Evidence on Effects Around the Oregon Rate Cap, 34 (3) Journal of Banking & Finance 546 (2010); Dean Karlan & Jonathan Zinman, Expanding Credit Access: Using Randomized Supply Decisions to Estimate the Impacts, Review of Financial Studies, 23 (1) Society for Financial Studies 433 (2010); Bart J. Wilson, David W. Findlay, James W. Meehan, Charissa P. Wellford, & Karl Schurter, An Experimental Analysis of the Demand for Payday Loans (April 28, 2010); Adair Morse, Payday Lenders: Heroes or Villains? (January 2009); Donald P. Morgan and Michael R. Strain, Payday Holiday: How Households Fare After Payday Credit Bans, Federal Reserve Bank of New York Staff Reports, No. 309, (November 2007, revised February 2008).

[19] Kelly D. Edmiston, Could Restrictions on Payday Lending Hurt Consumers?, Federal Reserve Bank of Kansas City Economic Review 31, 51 (First Quarter 2011) (describing costs that restrictions upon payday lending are likely to have for consumers in low-income counties or consumers with lower credit standing who are forced to substitute to more costly sources of credit).

[20] *See* Robert L. Clarke & Todd J. Zywicki, Payday Lending, Bank Overdraft Protection, and Fair Competition at the Consumer Financial Protection Bureau, 33 Review of Banking and Financial Law 235 (2013-2014).

payday lending also leads consumers to substitute to late bill payments or to bounce more checks.[21] Yet, while payday lending is obviously expensive, both overdraft protection and bounced check fees often exceed the cost to consumers of payday loans.[22] In fact, a recent *Wall Street Journal* article identified several banks located near military bases as deriving an unusually large amount of their revenues from overdraft and other fees and specifically identified the effects of the MLA as driving an increase in the use of overdraft protection by service members.[23]

In conclusion, I commend DoD's efforts to provide the most effective protections to service members and hope that this comment assists the DoD in formulating the most appropriate approach to achieving this goal. I appreciate your consideration of this comment and if you have questions or seek additional information, please contact my attorney advisor, Beth Delaney, at (202) 326-2903.

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[21] *See* Donald P. Morgan, Michael R. Strain & Ihab Seblani, How Payday Credit Access Affects Overdrafts and Other Outcomes, 44 Journal of Money, Credit & Banking 519 (2012) (finding that prohibiting payday lending leads to increased bounced check revenues at banks); Jonathan Zinman, Restricting Consumer Credit Access: Household Survey Evidence on Effects Around the Oregon Rate Cap, 34 Journal of Banking and Finance 546 (2010) (finding elimination of payday lending led consumers to greater use of overdraft protection and late bill payments).

[22] *See* Brian T. Melzer & Donald P. Morgan, Competition and Adverse Selection in a Consumer Loan Market: The Curious Case of Overdraft vs. Payday Credit (Dec. 2, 2009) (unpublished manuscript), *available at* http://www.clevelandfed.org/research/conferences/2010/9-9-2010_household-finance/melzer_morgan_2_16_2010.pdf.

[23] Mark Maremont and Tom McGinty, *Hefty Fees Waylay Soldiers: Banks that Market to Military are Among Top Collectors of Fees,* Wall St. J. page A1 (Jan. 15, 2014), *available in* http://www.wsj.com/news/articles/SB10001424052702304887104579306770984874320.