



February 1, 2018

The Honorable Robert L. Wilkie Jr.
Under Secretary of Personnel and Readiness
U.S. Department of Defense
1400 Defense Pentagon
Washington, DC 20301

Re: Request to amend Military Lending Act Limitations on Terms of Consumer Credit extended to Service Members and Dependents; Interpretive Rule Amendment - RIN 0890-ZA13

Dear Mr. Wilkie,

The Michigan Credit Union League (MCUL) is the statewide trade association representing 100% of the 232 credit unions located in Michigan. Credit unions are not-for-profit, member-owned financial cooperatives and have, from their inception, a longstanding tradition of protecting their members' interests.

While credit union lending products are subject to a wide variety of interlocking rules and regulations, recent guidance issued by the Department of Defense (DoD) have resulted in unnecessary confusion for credit unions serving military personnel while trying to comply with the Military Lending Act (MLA). While Michigan's credit unions have expressed concern with the regulatory and compliance burdens of the MLA since issuance of the original proposed rule, concerns have heightened since the December 2017 issuance of a revised Interpretive Statement that seeks to expand the 2015 rule without following the requirements of the Administrative Procedure Act.

Background

On August 26, 2016, the Department of Defense (DoD) issued guidance intended to clarify and assist the industry with regulatory and compliance concerns raised by financial institutions and trade associations nationally when complying with the 2015 final rule. The guidance provided a series of 19 Questions and Answers (Q&A) that according to the DoD, "represented official interpretations of the Department."

However, questions and concerns remained with a key point of contention regarding auto and vehicle financing. On December 14, 2017, the DoD published a second interpretive statement amending four of the Q&A interpretations.

Q&A Number 2 of the December 2017 interpretive statement is particularly concerning to credit unions. This specific Q&A relates to the auto finance industry and a lack of exemption for loans with credit-related products or similar services.

MCUL also has serious concerns with Q & A Number 2 with specific concerns regarding exemption of credit-related products like GAP insurance and credit insurance premiums from the definition of "consumer credit."

When analyzing the application of the MLA to a particular transaction, a lender must first determine if a borrower is a “covered borrower.” If the determination is made that a borrower is covered by the MLA, specific disclosures must be provided prior to the consummation of the loan. Because interpretations prior to December 2017 did not address indirect lending transactions, the disclosures required under the MLA have never been included in indirect lending contracts. If the DoD’s December 2017 interpretive statement stands as written, the disclosures are now required for any indirect loan in which GAP or other credit insurance is included, but not required if GAP or other credit insurance is not included. MCUL believes that this will result in confusion to both lenders and borrowers and will defeat the purposes underlying MLA.

To further clarify our position, the Truth in Lending Act (Regulation Z) 1026.4(a) defines “consumer credit” as credit offered or extended to a consumer primarily for personal, family or household purposes. The definition of “finance charge” is “the cost of consumer credit as a dollar amount including any charge payable directly or indirectly by a consumer and imposed directly or indirectly by a creditor as an incident to or condition of the extension of credit. GAP insurance is specifically included as an element of finance charge, and therefore part of “consumer credit”. DoD’s interpretation would then essentially give “consumer credit” a different definition than that found in Regulation Z.

The MLA defines “consumer credit” in essentially the same manner as Regulation Z defining “consumer credit” as “credit offered or extended to a covered borrower primarily for person, family or household purposes, and that is subject to a finance charge, or payable by a written agreement in more than four installments (See 32 CFR 232.3(f)(1). The MLA proceeds to make exceptions for the financing of vehicles and personal property where the vehicle or property purchased secures the loan, removing them from the requirements of the MLA. The amendments in the December 2017 interpretive statement places these same loans back under the umbrella of the MLA only if the loan has GAP or other credit insurance product. How is a credit union to know which loans are truly covered under the MLA with such widely differing interpretations of a similar definition?

Due to the lack of industry notice and ability to comment, pursuant to this arbitrary dictate, literally thousands of transactions processed after the December issuance were done so, and continue to be done so, out of compliance with the new interpretation of the MLA.

This is unacceptable and if the DoD intends to let this interpretation stand it, at a minimum, should provide credit unions and auto dealers adequate time to bring indirect lending contracts into compliance for covered borrowers.

Interpretive Rule and Guidance: Question and Answer Number 2

Q & A Number 2 of the 2016 Interpretive Guidance stated;

2. Does credit that a creditor extends for the purpose of purchasing personal property, which secures the credit, fall within the exception to “consumer credit” under 32 CFR 232.3(f)(2)(iii) where the creditor simultaneously extends credit in an amount greater than the purchase price?

Answer: No. Section 232.3(f)(1) defines “consumer credit” as credit extended to a covered borrower primarily for personal, family, or household purposes that is subject to a finance charge or payable by written agreement in more than four installments. Section 232.3(f)(2) provides a list of exceptions to paragraph (f)(1), including an exception for any credit transaction that is expressly intended to finance the purchase of personal property when the credit is secured by the property being purchased. A hybrid purchase money and cash advance loan is not expressly intended to finance the purchase of personal property, because the loan provides additional financing

that is unrelated to the purchase. To qualify for the purchase money exception from the definition of consumer credit, a loan must finance only the acquisition of personal property. Any credit transaction that provides purchase money secured financing of personal property along with additional "cashout" financing is not eligible for the exception under § 232.3(f)(2)(iii) and must comply with the provisions set forth in the MLA regulation.

The exceptions for the purchase of personal property and motor vehicles have extremely similar wording. This language leaves credit unions questioning whether motor vehicle purchase loans could be MLA covered loans when they exceed the purchase price of the vehicle. Situational examples include: the financing of negative equity, title, insurance or other add-ons. The December 14, 2017 guidance provided by the DoD offers some clarification to these situations, unfortunately not all those updates are positive for credit unions.

The 2017 clarifications now state:

2. Does credit that a creditor extends for the purpose of purchasing a motor vehicle or personal property, which secures the credit, fall within the exception to "consumer credit" under 32 CFR 232.3(f)(2)(ii) or (iii) where the creditor simultaneously extends credit in an amount greater than the purchase price of the motor vehicle or personal property?

*Answer: The answer will depend on what the credit beyond the purchase price of the motor vehicle or personal property is used to finance. Generally, financing costs related to the object securing the credit will not disqualify the transaction from the exceptions, **but financing credit-related costs will disqualify the transaction from the exceptions.***

This is a significant point of concern. If a borrower is purchasing a vehicle with an extended warranty, or even a leather interior package and the cost for such is included in the financing the loan would qualify for exemption from the MLA as it is considered expressly related to the vehicle. The December 2017 interpretive statement appears to take the position that Guaranteed Auto Protection (GAP) insurance or a credit insurance premium would now be specifically excluded from exemption. The new guidance goes on to state:

[I]n contrast, a credit transaction that also finances, a credit-related product or service rather than a product or service expressly related to the motor vehicle or personal property is not eligible for exceptions under 232.3(f)(2)(ii) and (iii). For example, a credit transaction that includes financing for Guaranteed Auto Protection insurance or a credit insurance premium would not qualify for exception under 232.3(f)(2)(ii) or (iii).

Credit related products are expressly and intrinsically related to the purchase of motor vehicles or personal property. They exist to secure the borrower and insured against risk of loss associated with the property financed. GAP insurance covers the loan deficiency on a destroyed or stolen vehicle loan, when the insurance paid is insufficient to cover the loan balance. For example, when an insurer deems a vehicle is a total loss, that insurer may only pay the current value of \$24,000, even though the outstanding debt is \$30,000. In this case, GAP pays the \$6,000 deficiency that the borrower would otherwise owe the lender. Traditionally, GAP is only available at the beginning of the loan and typically financed by the loan used to purchase the vehicle.

With these additional regulatory and compliance burdens imposed, credit unions may be forced to eliminate products and services that provide a safety net to their members and families, such as GAP insurance. If the DoD truly intends to expand the MLA to eliminate the exemption for credit-related products, it must do so in accordance with the APA. An amended rule must be promulgated, providing both consumers and the industry the opportunity to review and public comment.

Administrative Procedure Act

The DoD states in the latest guidance; *[T]he Department elected to inform the public of its views by issuing an interpretive rule in the form of questions and answers to assist industry in complying with the July 2015 Final Rule. The Department issued the first set of such interpretations on August 26, 2016. The present interpretive rule amends and adds to those questions and answers. This interpretive rule does not change the regulation implementing the MLA, but merely states the Department's preexisting interpretations of an existing regulation. Therefore, under 5 U.S.C. 553(b)(A), this rulemaking is exempt from the notice and comment requirements of the Administrative Procedure Act, and pursuant to 5 U.S.C. 553(d)(2), this rule is effective immediately upon publication in the Federal Register.*

The fact that a governmental agency refers to its guidance as interpretive is not, in and of itself, determinative of the issue. Rather, there is a need to look at the actual real effect of the rule. Where this is a substantial impact on the regulated industry, or an important class of the members or the products of that industry, notice and opportunity for comment should be provided. That is certainly the case here, where the December 2017 interpretive statement essentially rewrites the regulation, taking the position for the first time that the addition of GAP or credit insurance premiums result in loans that no longer qualify for the exemption. The far reaching and arbitrary nature of the recent issuance demonstrates the need for comment from interested parties. Had the DoD released the guidance for comment prior to publication, the agency would have been better informed on the issue presented herein, likely delivering much clearer guidance and removing ambiguity among two separate interpretations.

5 U.S.C. 553(c) states... *the agency shall give interested persons an opportunity to participate in the rule making through submission of written data, views, or arguments with or without opportunity for oral presentation. After consideration of the relevant matter presented, the agency shall incorporate in the rules adopted a concise general statement of their basis and purpose. When rules are required by statute to be made on the record after opportunity for an agency hearing, sections 556 and 557 of this title apply instead of this subsection.*

While 5 U.S.C. 553(d)(2) exempts interpretive rules from public comment had the DoD requested comment under 5 U.S.C. 553(c) a much different opinion may have been rendered by the Department, alleviating undue burden instead of adding additional burden.

Conclusion

The DoD has created a significant amount of confusion, specifically related to auto financing and indirect lending relationships as discussed. If the DoD intended to extend the scope of covered loans, particularly in indirect lending relationships when items such as GAP insurance or credit insurance is added, such intent was not conveyed sufficiently.

Because of the far-reaching impacts discussed, a significant policy change such as this requires notice and opportunity to comment. Due to the negative impact on credit union members, to whom would be considered covered borrowers under the MLA and the compliance uncertainty and challenges discussed above, MCUL requests the DoD go back to the drawing board and rescind Question and Answer number 2 of the Interpretive Statement. This is to allow the DoD to review concerns that have been raised since issuance and consider comments from the industry prior to amending the guidance.

We look forward to working with the Department on refining the Interpretive Statement to provide protections to servicemembers without limiting availability of loans credit unions can provide.

Sincerely,

A handwritten signature in black ink, appearing to be the initials 'KR' with a stylized flourish extending from the bottom right.

Ken Ross
President/COO
Michigan Credit Union League