

April 7, 2016

Marcus Beauregard, Colonel, USAF (Retired)
Chief of the DoD-State Liaison Office
Office of the Deputy Assistant Secretary of Defense for Military
Community and Family Policy

Dear Col. Beauregard:

The American Financial Services Association (“AFSA”)¹ very much appreciates the Department of Defense (“DOD”) and the Interagency Working Group’s willingness to consider clarifications to the Military Lending Act Regulations (“MLA Rule”). We appreciate the time that the DOD and Interagency Working Group took to meet with us and others in March. We hope that you will consider the suggestions below.

Section 232.4 Terms of consumer credit extended to covered borrowers.

Credit-Related Ancillary Products

Section 232.4(c)(1)(ii) states that the charges included in the Military Annual Percentage Rate (“MAPR”) include, as applicable to the extension of consumer credit, any fee for a credit-related ancillary product sold in connection with the credit transaction for closed-end credit or an account for open-end credit. AFSA respectfully requests that the DOD offer a specific definition of “credit-related ancillary product.” We pose the following definition for consideration by the DOD:

“Credit-Related Ancillary Product means any product or service that is sold directly or indirectly by the creditor to the covered borrower as an optional product to the consumer credit transaction subject to the MLA regulation that, in whole or in part, waives, pays, reduces, or satisfies an amount due to a creditor from a covered borrower.”

This definition captures products that are true credit products and are related to the financing, but excludes products, such as product warranties, that could be sold to a consumer separately from the financing. In the alternative, we respectfully request that the DOD publish guidance that expressly states that a credit-related ancillary product does not include products that could be sold to a consumer separately from the financing, such as a product warranty.

¹ Founded in 1916, AFSA is the national trade association for the consumer credit industry, protecting access to credit and consumer choice. AFSA members provide consumers with many kinds of credit, including traditional installment loans, mortgages, direct and indirect vehicle financing, payment cards, and retail sales finance.

Exceptions

Section 232.4(c) (iii) provides a limited number of exemptions to the charges included in the MAPR. We ask that the DOD consider specifying that any fee associated with disbursing loan proceeds is exempt from the MAPR. The DOD could either add a new exemption as section 232.4(c) (iii) (D) or clarify that the fee in section 232.(c) (iii) (C) ("Any fee imposed for participation in any plan or arrangement for consumer credit, subject to paragraph (c) (2) (ii) (B) of this section"), includes fees associated with disbursing loan proceeds. The reason for not including the disbursement fee is that the fee is used to cover costs associated with an expedited and often expensive service. This would be a premium service offered to service members and their families who need funds faster than electronic transfer of funds can provide.

Section 232.5 Optional identification of covered borrower.

Section 232.5(a) allows a creditor to apply its own methodology to assess whether a consumer is a covered borrower. However, section 232.5(b) states that for the purposes of a safe harbor, a creditor may conclusively determine whether credit is offered or extended to a covered borrower, and thus may be subject to 10 U.S.C. 987 and the requirements of the MLA Rule, by assessing the status of a consumer in one of two ways: (1) by using information relating to that consumer, if any, obtained directly or indirectly from the database maintained by the DOD; or (2) by using a statement, code, or similar indicator describing that status, if any, contained in a consumer report obtained from a consumer reporting agency ("CRA") that compiles and maintains files on consumers on a nationwide basis, or a reseller of such a consumer report.

AFSA is very grateful to the DOD for including the CRA safe-harbor provision. Allowing creditors the safe harbor of being able to purchase covered borrower information from a CRA will help creditors and service members alike. We do have an important question about the safe harbor that we hope the DOD will answer. Would the DOD be willing to provide information about how a creditor could take advantage of the safe harbor if the DOD's website was down or it was not possible to get information from a CRA (a power outage at the CRA, for example)? AFSA suggests that an alternative safe harbor should be recognized and allowed if the creditor shows that a covered borrower check was performed and that official information was not available, together with the applicant's oral or written assertion that he or she is not a covered member.

Furthermore, Section 232.5(b) (3) says that a creditor who makes a determination regarding the status of a consumer by using one or both of the covered borrower verification methods meets the safe harbor, as long as that creditor timely creates and thereafter maintains a record of the information so obtained. It would be more clear if the DOD will confirm expressly that the creditor may rely on the information presented, even if by chance it happened to be inaccurate. We suggest that the DOD borrow the language from the Illinois Payday Reform Act (815 ILCS 122/) which states, "A licensee [in this case, a creditor] may rely

on the information contained in the certified database as accurate and is not subject to any administrative penalty or liability as a result of relying on inaccurate information contained in the database.”

Section 232.6 Mandatory loan disclosures.

Section 232.6(d)(2) requires a creditor to provide a covered borrower with oral disclosures of the information required by sections 232.6(a)(1) and 232.6(a)(3). Section 232.6(a) requires these oral disclosures to be given before or at the time a borrower becomes obligated. Section 232.6(a)(3) is a clear description of the payment obligation, which means a payment schedule for closed-end loans. In some cases, it may be impossible for some creditors to disclose a payment schedule before the covered borrower has executed the loan. For example, if the covered borrower applied on-line, the loan documents may then be e-mailed to the covered borrower. Before the loan documents are created, emailed, and signed, it would be impossible for the creditor to orally provide a payment schedule. We therefore offer three suggestions that the DOD might consider. We believe that these alternatives still meet the objective of providing information to covered borrowers orally. The three suggestions are:

- (1) The DOD could allow creditors to provide the oral disclosures in section 232.6(a)(3) after the loan documents are signed.
- (2) The DOD could permit lenders to provide an estimate using a hypothetical loan. The DOD might consider the model set forth in Regulation Z for private education loans where a creditor has to provide three disclosures timed to loan application, approval, and execution. Regulation Z requires the creditor to provide the application disclosure based on cost estimates (see 12 C.F.R. § 1026.47(a)(4)).
- (3) The DOD could clarify that a creditor may orally provide a generic description of the payment schedule that is applicable to all covered borrowers as opposed to a borrower-specific payment schedule. This generic payment schedule would provide, for example, that the borrower must repay her loan by making monthly payments during the term of the loan. Such a generic schedule of this type would permit the creditor to supply the applicant with the 800 number contemplated by Section 232.6(d)(2)(iii) for the applicant to call and hear a recording of the Section 232(c)(3) model statement and the generic payment schedule, all before she decides to obtain the loan.

Section 232.8 Limitations.

Waivers

Section 232.8(b) prohibits creditors from requiring covered borrowers to waive their right to legal recourse under any otherwise applicable provision of state or federal law, including any provision of the Servicemembers Civil Relief Act (“SCRA”). There is not currently any

guidance as to what specific waivers are covered under this prohibition.

The rationale for the prohibition appears to have originated from the DOD's "Report on Predatory Lending Practices Directed at Members of the Armed Forces and Their Dependents," ("Report") which was published on Aug. 9, 2006. In the Report, the DOD expressed concern regarding loan contracts that include waivers of meaningful legal redress. More specifically, the DOD took issue with consumer credit contracts that included mandatory arbitration clauses, onerous notice provisions, waivers of right of recourse (such as waiver of the right to participate in a plaintiff class), or waivers of any special legal protections awarded to service members, such as those under the SCRA. Such provisions appeared to pose a problem to the DOD because the waivers were not a matter of choice in these contracts. Accordingly, the Report recommended that such provisions be prohibited in contracts with service members. These same concerns regarding waivers of meaningful legal redress were cited by the DOD in the Supplemental Information provided with the original Military Lending Act regulations (72 Fed. Reg. 50580, 50581, 8/31/2007).

However, while waivers of meaningful legal redress clearly fall within the prohibition, the provision also includes a broad prohibition making it unlawful for creditors to require covered borrowers to waive their right to legal recourse under any provision of SCRA. While the SCRA does provide specialized protections related to a service member's ability to seek meaningful legal redress, it also contains other more substantive protections, including provisions that reduce the interest rate on pre-existing loans and obligations and provisions that allow for early termination of residential and motor vehicle leases without incurring an early termination charge. The broad language in this section has the potential to harm service members by prohibiting these substantive protections.

Moreover, the language in section 232.8(b) is so broad that it appears that the DOD is prohibiting explicit waivers. For example, a standard consumer credit promissory note often includes the following multi-state waiver language: "Waivers. To the extent not prohibited by law, I [borrower] waive protest, presentment for payment, demand, notice of acceleration, notice of intent to accelerate, and notice of dishonor." Protest, presentment, demand and notice of dishonor are negotiable instrument concepts, the waiver of which has been recognized by the Federal Reserve Board and specifically permitted by the Uniform Commercial Code. Notice of acceleration and notice of intent to accelerate are statutory and/or common law concepts, the waiver of which is also often permitted by state law. Most consumer promissory notes are negotiable instruments and include these standard waivers to make them as liquid and transferable as possible and to allow creditors to reduce and control costs that would otherwise have to be passed on to consumers.

We request that the DOD explain that the prohibition on requiring covered borrowers to waive their right to legal recourse be limited to arbitration clauses, onerous notice provisions, and waivers of the right to participate in a plaintiff class, and that it does not apply to waivers of protest, presentment for payment, demand, notice of acceleration, notice of intent to accelerate, and notice of dishonor.

Vehicle Titles

Section 232.8(f) makes it unlawful for any creditor to extend consumer credit to a covered borrower with respect to which the creditor uses the title of a vehicle as security for the obligation involving the consumer credit, provided however, that for the purposes of this paragraph, the term “creditor” does not include a person that is chartered or licensed under Federal or State law as a bank, savings association, or credit union. We have two comments on this limitation.

First, it would be helpful if the DOD provided a definition of “vehicle.” We offer the DOD a definition of “vehicle” based on the definition used by the CFPB in its rule, Defining Larger Participants of the Automobile Financing Market and Defining Certain Automobile Leasing Activity as a Financial Product or Service (80 FR 37495, 6/30/2016). Our proposed definition is:

“Vehicle means any self-propelled motor vehicle primarily used for personal, family, or household purposes for on-road transportation. The term does not include motor homes, recreational vehicles (RVs), golf carts, off-road dirt bikes, snow mobiles, ATVs, motor scooters, boats, or water vessels.”

Second, although possibly unintentional, this section appears to prohibit non-depository lenders from refinancing vehicle loans or credit sales (using the title of the vehicle as security), even at a lower rate. We anticipate this language was intended to prohibit motor vehicle title loans, but as drafted, it could also be interpreted to prohibit state-licensed traditional installment lenders from making loans to refinance a covered borrower's purchase of a motor vehicle. Is there a way that the DOD could allow for a refinance using the vehicle title as security, if it was beneficial for the covered borrower? AFSA asks that the DOD consider clarifying that the creditor may not use the title of a vehicle as security, except to refinance any credit transaction that is expressly intended to finance the purchase of a motor vehicle when the credit is secured by the vehicle that was purchased, as these initial purchase money transactions are already excluded from the definition of consumer credit.

Section 232.9 Penalties and remedies.

Under the regulation, the bona fide error defense only applies to civil liability under section 232.9(e). However, it seems that the bona fide error defense should apply to all potential penalties in section 232.9. Would the DOD consider applying the bona fide error defense to sections (a) through (c) as well?

Conclusion

AFSA thanks that DOD and the Interagency Working Group for their time and attention in addressing these issues. We are ready to answer any questions or help in any way. Please contact me by phone, 202-466-8616, or e-mail, bhimpler@afsamail.org, with any questions.

Sincerely,



Bill Himpler
Executive Vice President
American Financial Services Association