



June 21, 2017

The Honorable James Mattis
Secretary of Defense
1000 Defense Pentagon
Washington, DC 20301-1000

Dear Mr. Secretary,

As we approach the first anniversary of the implementation of the Department of Defense's amended Military Lending Act (MLA) Regulation, the Financial Trade Associations – the American Bankers Association, the American Financial Services Association, the Association of Military Banks of America, the Consumer Bankers Association, the Credit Union National Association, the Independent Community Bankers of America, and the National Association of Federally-Insured Credit Unions – offer our thanks for your willingness to work with us to ensure the MLA works for both the military community and the financial organizations that serve it. For example, the Department's Interpretive Rule, released last August, addressed many of our concerns and thereby avoided unintended adverse consequences military families would otherwise have suffered.

Despite almost a year's experience under the amended Regulation, confusion remains about the meaning of several its most important provisions. Additionally, there remain multiple inconsistencies between the Regulation and the Department's Interpretive Rule. Together, this confusion and these inconsistencies make it likely that service members and their families might not have full access to safe and responsible credit options.

We share a desire to ensure responsible credit remains available to all military members and families and believe the Department can best achieve that goal by issuing an interim final rule for public comment that eliminates confusion and inconsistency in this area. The attached letter explains these issues in detail and offers solutions and language for an interim final rule. Because a considerable number of these issues arise in the credit card arena, we also respectfully urge the Department to exercise its authority to extend the MLA Regulation's effective date for credit card accounts to 3 October 2018. These two steps are critical to the financial industry's smooth and effective implementation of the MLA regulations strict standards. They have the added benefit of advancing President Trump's mandate to reduce the number and burden of administrative regulations.

The Financial Trade Associations thank the Department again for its collaborative spirit and the work we have done together for the benefit of our military members and their families. We look forward to continuing that work to ensure the financial products and services available to them are equivalent in quality and quantity to those available to the general public.

Sincerely,

Nessa A. Feddis

Senior Vice President & Deputy Chief Counsel
American Bankers Association

Celia Winslow

Director, Legal & Regulatory Affairs
American Financial Services Association

Steven J. Lepper

Major General, USAF (Ret.)
President & CEO
Association of Military Banks of America

David Pommerehn

Vice President & Associate Senior Counsel
Consumer Bankers Association

Elizabeth Eurgubian

Deputy Chief Advocacy Officer & Senior Counsel
Credit Union National Association

Viveca Y. Ware

Group Executive Vice President, Regulatory Policy
Independent Community Bankers of America

Alexander Monterrubio

Director of Regulatory Affairs
National Association of Federally-Insured Credit
Unions

cc: The Honorable Richard Cordray, Director, Consumer Financial Protection Bureau³

Military Lending Act Rule (32 C.F.R. pt. 232)

Recommended Clarifications and Modifications
June 2017

The American Bankers Association, the American Financial Services Association, the Association of Military Banks of America, the Consumer Bankers Association, the Credit Union National Association, the Independent Community Bankers of America, and the National Association of Federally-Insured Credit Unions, (collectively, the “Trade Associations”)¹ respectfully submit the following recommended clarifications and modifications to the regulation implementing the Military Lending Act (“MLA”).² The Trade Associations appreciate the efforts of the Department of Defense (“the Department”) to provide guidance, particularly its August 2016 Interpretive Rule,³ and the Department’s willingness to meet with the Trade Associations and industry representatives to discuss additional changes necessary to ensure that the MLA Regulation does not prevent servicemembers and their families from having access to safe and responsible credit.

We respectfully urge the Department to take action as soon as possible to fulfill its obligations to reduce the overall number and burden of regulations under President Trump’s Executive Orders 13771 (Reducing Regulation and Controlling Regulatory Costs), 13772 (Core Principles for Regulating the United States Financial System), and 13777 (Enforcing the Regulatory Reform Agenda).⁴ Among the goals of those executive orders are making regulations “efficient, effective, and appropriately tailored” while empowering “Americans to make independent financial decisions and informed choices in the marketplace.”

While the August 2016 Interpretive Rule addressed some of the key implementation issues in advance of the initial October 3, 2016 mandatory compliance date, it left some issues unresolved and, in a few cases, created new challenges that the Department may not have intended. Based on our members’ experience in implementing and complying with the MLA Regulation, we have identified several issues that are disrupting the industry’s ability to serve this important population. These issues are discussed in detail below, along with proposed solutions that the Department can quickly implement through an interim final rule that makes targeted clarifications and modifications to the MLA Regulation.

Perhaps most urgently, we respectfully request that the Department use its authority as soon as possible to issue an order extending the MLA Regulation’s effective date for credit card accounts to October 3, 2018. Unfortunately, the extension of the MLA Regulation to cover credit card accounts under an open-end (not home-secured) consumer credit plan (“Credit Card Accounts”), which is scheduled to take effect on October 3, 2017, has resulted in a set of requirements that are unworkable for the industry and will restrict issuers’ ability to make this essential product fully available to servicemembers and their families. Fortunately, however, the Department foresaw this possibility and expressly provided in the MLA Regulation that it could

¹ Please see trade association descriptions at the end of this letter.

² 32 C.F.R. Part 232 (“MLA Regulation”).

³ 81 Fed. Reg. 58840 (Aug. 26, 2016) (“August 2016 Interpretive Rule”).

⁴ Exec. Order No. 13,771, 82 Fed. Reg. 9339 (Jan. 30, 2017); Exec. Order No. 13,772, 82 Fed. Reg. 9965 (Feb. 3, 2017); Exec. Order No. 13,777, 82 Fed. Reg. 12285 (Feb. 24, 2017).

extend the compliance date for Credit Card Accounts by one year without further rulemaking.⁵ The Department should do so immediately to give itself and the industry time to find a more workable solution. As discussed below, we believe that an exemption is appropriate for credit card products that are already subject to the robust consumer protections in the Credit Card Accountability Responsibility and Disclosure Act.⁶

Because urgent action is necessary to avoid further disruption in access to credit for servicemembers and their families, we urge the Department to use its authority to issue an interim final rule amending the MLA Regulation, followed by a public comment period to address any outstanding issues. Only a rule revising the MLA Regulation can bring the clarity and certainty required by consumers, industry, regulators, and courts. In contrast, another interpretive rule, while helpful, cannot provide this certainty and cannot address issues that require a change to the regulation itself. However, a rulemaking with an advance comment period would mean a delay of a year or more. Therefore, we urge the Department to use its authority, as discussed below, to issue an interim final rule. Most of the changes we are seeking are clarifying in nature and should provoke little, if any, controversy or comment. Thus, comment can be taken after the rule is issued, and the Department can make any needed adjustments when it removes the rule from “interim” status.

Please contact Nessa Feddis (nfeddis@aba.com, 202-663-5433), Steven Lepper (Steven.Lepper@AMBAHQ.org, 540-347-3305) or Bill Himpler (bhimpler@afsamail.org, 202-466-8616) for further information.

The Department’s Authority to Amend the MLA Regulation

While the industry appreciates the Department’s efforts to provide guidance through the August 2016 Interpretive Rule, interpretive guidance does not address issues that require a change to the regulation itself, especially those provisions that are inconsistent with the regulation. In any legal challenge, the regulation will prevail over an interpretive rule if there is any inconsistency. Therefore, we respectfully request that the Department instead issue an interim final rule amending the regulation so that there is a single, consistent source of law for servicemembers and their families and the financial institutions that serve them, as well as for regulators and courts.

The Secretary Has the Authority to Adjust the MLA’s Requirements

The MLA grants the Secretary of Defense (“the Secretary”) authority to issue rules to “carry out this section,” which by itself is a broad grant of authority.⁷ The MLA further directs the Secretary to establish the following by regulation:

⁵ 32 C.F.R. § 232.13(c)(2) (“The Secretary, or an official of the Department duly authorized by the Secretary, may, by order, extend the expiration of the exemption [for Credit Card Accounts] set forth in paragraph (c)(1) of this section, until a date not later than October 3, 2018.”).

⁶ Pub. L. No. 111-24, 123 Stat. 1734 (2009) (“CARD Act”).

⁷ 10 U.S.C. § 987(h)(1).

- A method for calculating the APR “in accordance with the limit established under this section;”⁸
- A cap on fees and the types of fees that may be charged on covered transactions, which must be disclosed as “a total amount, and as a percentage of loan principal” at the time the consumer enters into the transaction;⁹ and
- Definitions of “creditor” and “consumer credit” that are “consistent with this section.”¹⁰

In addition, the MLA gives the Secretary broad discretionary authority to establish by regulation “such other criteria or limitations as the Secretary of Defense determines appropriate, consistent with the provisions of this section.”¹¹

Taken together, these provisions grant the Secretary ample authority to revise the MLA Regulation to accommodate the recommended changes set forth below. The Secretary used these authorities to issue regulations implementing the MLA in August 2007¹² and again in July 2015¹³ when it adopted the most recent amendments. Thus, there is precedent for the Secretary to use the authority granted in the MLA to amend the regulation from time to time. Moreover, under Section 987(h)(3) of the statute, in prescribing the regulations, the Department must consult with the various federal agencies every two years. As noted, the Department released the last amendments to the rule in July 2015 so it is due to revisit the regulation.

In conjunction with the Secretary’s authority to issue rules to carry out the MLA, Section 987(h) also directs the Secretary to “fill in the blanks” by establishing specific requirements through regulation for certain statutory provisions, including, for example, the APR calculation method, caps on fees, and defining key terms such as “creditor” and “consumer credit.”

Thus, it is clear that the Secretary has the authority to make the recommended changes to the MLA Regulation.

The Secretary Should Use Its Authority to Amend the Regulation by Interim Final Rule

As discussed below, the industry is already struggling to provide credit to servicemembers and their families due to ambiguities in the amended MLA Regulation and anticipates even greater difficulty if compliance becomes mandatory for Credit Card Accounts on October 3, 2017. Notice and comment rulemaking can take a year, and often longer, to complete. Thus, it is in the best interests of all concerned – particularly servicemembers and their families – to avoid further disruptions in credit availability by making the necessary clarifications and modifications in an interim final rule, to be issued as quickly as possible.

⁸ *Id.* at § 987(h)(2)(B).

⁹ *Id.* at § 987(h)(2)(C).

¹⁰ *Id.* at § 987(h)(2)(D).

¹¹ *Id.* at § 987(h)(2)(E).

¹² 72 Fed. Reg. 50580 (Aug. 31, 2007).

¹³ 80 Fed. Reg. 43560 (July 22, 2015).

These circumstances merit an interim final rule with comment taken after the rule is issued. The Administrative Procedure Act (“APA”) generally requires the agency to give the public advance notice and an opportunity to comment on a “legislative rule,” which is a rule with binding effect.¹⁴ However, the APA permits an agency to bypass advance notice and comment for: (1) interpretations of its own rules (as the Department did when issuing its Interpretive Rule in August 2016); and (2) circumstances in which the agency “for good cause finds that notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest.”¹⁵ Interim final rules give the public an opportunity to comment—typically, the comment period begins with the publication of the interim final rule. After the comment period ends, the agency can then make adjustments to the interim final rule in a subsequent “final” final rule.

Here, a standard rulemaking process with advance notice and comment would be “impracticable” if the Department wishes to ensure that the existing issues with the MLA Regulation and the upcoming issues related to Credit Card Accounts do not impair access to credit for servicemembers and their families and do not negatively impact military readiness. Since the Department first proposed a rule to implement the MLA in 2007, ensuring military readiness has been the regulation’s goal.¹⁶ Courts have approved interim rules without advance notice and comment and shortened comment periods when similar concerns were implicated.¹⁷ Other agencies, including the Consumer Financial Protection Bureau (“Bureau”) and the Federal Reserve Board, have issued interim final rules to avoid disruptions to the flow of consumer credit.¹⁸

¹⁴ 5 U.S.C. § 553(b) and (c).

¹⁵ *Id.* at § 553(b)(3)(A) and (B).

¹⁶ “The Department views the support provided to military families as essential to sustaining force readiness and military capability. From this perspective, it is not sufficient for the Department to train Service members on how best to use their financial resources—financial protections are an important part of fulfilling the Department’s compact with Service members and their families.” 72 Fed. Reg. at 50580; *see also* 79 Fed. Reg. 58602, 58605 (Sep. 29, 2014) (“The Department makes a significant investment in recruiting, training and retaining highly qualified Service members. The Department expects these Service members to maintain personal readiness standards, including paying their debts and maintaining their ability to attend to the financial needs of their families.”).

¹⁷ *Nw. Airlines v. Goldschmit*, 645 F.2d 1309, 1320 (8th Cir. 1981) (upholding FAA’s temporary rule issued without advance notice and comment allocating air carrier slots in Washington, DC airport); *Nat’l Customs Brokers and Forwarders Ass’n of Am. v. United States*, 59 F.3d 1219, 1223 (Fed. Cir. 1995) (upholding Customs Service’s interim rule that would result in economic benefits intended by Congress); *Am. Fed’n of Gov’t. Emps. v. Block*, 655 F.2d 1153 (D.C. Cir. 1981) (Department of Agriculture reasonably published interim rules effective immediately to avoid disruption to the poultry industry and ensuing economic harm, in response to a court directive).

¹⁸ For example, the Bureau has issued the following interim final rules: 77 Fed. Reg. 67744 (Nov. 14, 2012) (corrections to Regulation V, FCRA); 78 Fed. Reg. 62993 (Oct. 23, 2013) (amendments to Regulations Z and X, mortgage servicing); 81 Fed. Reg. 16074 (Mar. 25, 2016) (revisions to Regulation Z, for certain balloon payment mortgages). The Federal Reserve has also issued numerous interim final rules over the years, including, for example: 75 Fed. Reg. 66554 (Oct. 28, 2010) (revisions to Regulation Z’s appraisal independence requirements); 74 Fed. Reg. 60143 (Nov. 11, 2009) (revisions to Regulation Z, transfer of mortgage loan ownership); 74 Fed. Reg. 36077 (July 22, 2009) (to make changes to Regulation Z’s credit card requirements); and 71 Fed. Reg. 1473 (Jan. 10, 2006) (amending Regulation E to include payroll card requirements).

In this case, the Department’s goal of military readiness will be undermined by delaying the necessary action while waiting to complete an unnecessary advance notice and comment period. Comments can be taken for an appropriate period after the interim final rule is issued, and the Secretary can make any appropriate adjustments to the rule at a later date through a public notice in the Federal Register.

Discussion of Specific Issues and Solutions

I. Scope of the MLA Regulation: *Coverage of Purchase Money Vehicle and Personal Property Financing*

- **Background:** Section 987(i)(6)(B) of the statute exempts from the definition of consumer credit “a loan procured in the course of purchasing a car or other personal property, when that loan is offered for the express purpose of financing the purchase and is secured by the car or personal property procured.” To implement the statute, § 232.3(f)(2)(ii) of the MLA Regulation exempts from the definition of “consumer credit” – and therefore from coverage under the MLA Regulation – “[a]ny credit transaction that is expressly intended to finance the purchase of a motor vehicle when the credit is secured by the vehicle being purchased.” Similarly, § 232.3(f)(2)(iii) exempts “[a]ny credit transaction that is expressly intended to finance the purchase of personal property when the credit is secured by the property being purchased.”

Interpretive Rule Question and Answer (“Q&A”) 2 states:

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?

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.¹⁹

Although Q&A 2 only references the exemption for personal property purchase loans, some are concerned that the nearly identical language in § 232.3(f)(2)(ii) and (iii) might

¹⁹ 81 Fed. Reg. 58840, 58841 (Aug. 26, 2016).

lead to the Q&A being interpreted to apply to motor vehicle purchase financing. In addition, the Bureau's examination procedures apply Interpretive Rule Q&A 2, above, to personal property and motor vehicles.²⁰

- **Issue:** We believe that the Department intended Q&A 2 to prevent "sham" transactions that are structured to evade the MLA Regulation. The regulation exempts "any credit that is expressly intended to finance the purchase of personal property when the credit is secured by the property being purchased." It does not limit the amount of such financing to the purchase amount or value of the property securing the financing. Thus, for example, a financial institution could argue that a \$1,200 extension of credit that funds the purchase of an unrelated \$200 item is exempt as long as the financial institution takes a security interest in the \$200 item. Q&A 2 appears to have been intended to clarify that such cash-out financings are not exempt.

We appreciate the Department's goals in issuing this interpretation. However, the language in Q&A 2 of the Interpretive Rule limiting the purchase money exception to arrangements that finance "only the acquisition of personal property" has created serious – and, we believe, unintended – consequences.

Most notably, it is common practice for borrowers to finance not only the purchase price of a motor vehicle but also the amounts necessary to pay off the loan on the borrower's trade-in vehicle and to pay for items that are clearly related to the purchase of a vehicle but that will not be used to secure the credit. For servicemembers and their families, the language in Q&A 2 may create substantial hurdles to covered borrowers who wish to obtain financing.

For various reasons, including for example a change of station order, borrowers frequently need financing to pay off the loan or retail installment sales contract on an old car they wish to trade in as they purchase a new car. Similarly, borrowers often finance items that are essential to the purchase, such as sales tax and title, registration, and delivery fees. If covered borrowers were unable to finance these items, it may render the purchase of a new vehicle unaffordable for many covered borrowers, particularly if financing is needed to pay off the loan or retail installment sales contract for the trade-in vehicle.

Other costs related to the vehicle purchase that are negotiated with the overall purchase price of the vehicle cannot be easily separated from that price. These include, for example, options, upgrade packages, extended warranties, service plans, and GAP insurance. Furthermore, there are other voluntary charges that are clearly related to the financing of the vehicle purchase, such as credit insurance and payment protection plans.

²⁰ CFPB, *MLA Interagency Examination Procedures*, MLA3 (2015), available at: http://files.consumerfinance.gov/f/documents/092016_cfpb_MLAExamManualUpdate.pdf.

Issues similar to these mentioned above for vehicle financing arise with arrangements to finance the purchase of personal property where the option to finance state sales taxes, shipping and handling/delivery fees, extended warranties, insurance, credit protection products, and other items are not available to covered borrowers to the same extent as other borrowers.²¹

The lack of certainty has caused financial institutions to refuse to finance certain items (such as extended car warranties) for covered borrowers or for all borrowers, which means that covered borrowers and others have to forego or pay cash for these complementary items that are standard and even necessary components related to the good being purchased. It has also meant that covered borrowers may not be able to use the new financing to repay the loan or retail installment sales contract secured by the “trade-in” vehicle, which can render the transaction unaffordable. We are not aware of any abuses or potential abuses related to such financing that should disqualify these arrangements from the exemption.

Neither the statute nor the MLA Regulation requires that the borrower only finance the item on which a purchase money security interest is taken in order for the financing to be excluded from the definition of consumer credit. Both the statute and the MLA Regulation exempt purchase money financing arrangements even if they are used to finance other items or to get cash. Thus, the statute and MLA Regulation clearly permit such financing, and they would prevail over any inconsistent provision in an interpretive rule. However, the inconsistency of the August 2016 Interpretive Rule, the uncertainty of its meaning, and fear of violations have caused some financial institutions to limit financing options to servicemembers and their families (or in some instances to all borrowers) so that they are unable to finance items related to their purchase.

- **Proposed Solution:** Amend § 232.3(f)(2) as follows:

(2) *Exceptions.* Notwithstanding paragraph (f)(1) of this section, consumer credit does not mean:

(i) ***

(ii) Any credit transaction that is expressly intended to finance the purchase of a motor vehicle when the credit is secured at least in part by the vehicle being purchased and none of the proceeds from the financing arrangement are provided directly to the borrower in the form of cash or its equivalent.

(iii) Any credit transaction that is expressly intended to finance the purchase of personal property when the credit is secured at least in part by the property being purchased and none of the proceeds from the financing arrangement are provided directly to the borrower in the form of cash or its equivalent.

²¹ For example, a covered borrower may need to finance the purchase of a refrigerator, stove, or other major home appliance. Many covered borrowers – just like other borrowers – would prefer the option to also finance sales taxes, delivery fees, installation fees, and warranty costs.

II. Scope of the MLA Regulation: *Coverage of Recreational Vehicles*

- **Background:** Q&A 19 states:

Under 32 CFR 232.3(f)(2)(ii) and 232.8(f) what methods of transportation are included within the definition of a “vehicle”?

Answer: For purposes of the MLA, the term “vehicle” means any self-propelled 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, or motor scooters.²²

- **Issue:** Most state laws treat recreational vehicles as motor vehicles for licensing, taxation, registration, and financing purposes. While the different treatment of motor homes, golf carts, and motor scooters may be warranted under state law, recreational vehicles are more akin to motor vehicles than any other class of property. Further, Q&A 19 leaves unresolved the status of all four of these items—if they are not vehicles, it appears that such items should be treated as personal property.
- **Proposed Solution:** Amend § 232.3(f)(2)(ii) as follows:

(2) *Exceptions.* Notwithstanding paragraph (f)(1) of this section, consumer credit does not mean:

(i) ***

(ii) Any credit transaction that is expressly intended to finance the purchase of a motor vehicle (including but not limited to a recreational vehicle) **when *****

Note: This amendment can be combined with the preceding amendment to § 232.3(f)(2)(ii).

III. Scope of the MLA Regulation: *Coverage of Loans Secured by Vacant Lots*

- **Background:** Section 232.3(f)(2)(i) exempts from the definition of “consumer credit” – and therefore from coverage under the MLA Regulation – “[a] residential mortgage, which is any credit transaction *secured by an interest in a dwelling*, including a transaction to finance the purchase or initial construction of the dwelling, any refinance transaction, home equity loan or line of credit, or reverse mortgage.” (Emphasis added.) Borrowers often purchase vacant land with a loan secured by the land with the intention of building a dwelling in the future (“lot loans”). Such loans are not exempt from the MLA Regulation.

²² 81 Fed. Reg. at 58845 (emphasis added).

- **Issue:** There is no policy reason to exempt all real-estate secured loans except those without a dwelling. Furthermore, because lot loans are relatively rare, financial institutions may choose to not make lot loans to covered borrowers rather than build an expensive compliance process to make a small number of loans. The Department has the ability to address this situation, using their authority in the MLA to define the term “consumer credit.”

- **Proposed Solution:** Amend § 232.3(f)(2) as follows:

(2) *Exceptions.* Notwithstanding paragraph (f)(1) of this section, consumer credit does not mean:

(i) A residential mortgage, which is any credit transaction secured by an interest in real property or a dwelling, including a transaction to finance the purchase or initial construction of the dwelling, any refinance transaction, home equity loan or line of credit, or reverse mortgage.

IV. Scope of the MLA Regulation: *Coverage of Secured Purchase Money Loans*

- **Background:** Under certain circumstances, loans to purchase securities that are used to secure the loan are covered under Regulation Z. However, it is not clear that securities are “personal property” under the MLA Regulation and thus subject to the exemption for purchase money loans for personal property.
- **Issue:** Because such loans to purchase securities are relatively uncommon, creditors may choose to decline servicemembers and their families such loans rather than set up an entire compliance system for a situation that rarely, if ever, will be presented. The Department has the ability to address this situation, using its authority in the MLA to define the term “consumer credit.”
- **Proposed Solution:** Amend § 232.3(f)(2)(iii) as follows:

Any credit transaction that is expressly intended to finance the purchase of personal property including securities when the credit is secured by the property being purchased.

Note: This amendment can be combined with the preceding amendment to § 232.3(f)(2)(iii).

V. Scope of the MLA Regulation: *Limitation on the Use of Vehicle Title as Security*

- **Background:** Section 987(e)(5) of the MLA prohibits a creditor from extending credit to a covered borrower if the creditor uses “the title of a vehicle as security for the obligation.” The preamble to the MLA Regulation states that “the Department has determined that certain classes of lenders should remain available to conduct refinancing transactions for consumer credit that involve the use of the title of a vehicle as security, and that the appropriate classes of lenders for this purpose are banks, thrifts, and credit unions supervised by federal or state regulators.”²³ Further, “the Department has determined that if the restriction against using the title of a vehicle as security for consumer credit were to apply to any creditor, without limitation, then many covered borrowers undoubtedly would be denied opportunities to favorably refinance existing auto loans, particularly to take advantage of falling interest rates.”²⁴ The previous version of the MLA Regulation allowed covered lenders to make such loans regardless of charter or license if “the new transaction results in more favorable terms to the covered borrower, such as a lower MAPR.”²⁵

Issue: We appreciate the Department’s conclusion that the statutory provisions were intended to address loans made by payday lenders and its efforts to adjust the statute to allow some creditors “to extend other forms of consumer credit, such as workout loans and other refinancing transactions . . . particularly when lower interest rates are available to those [covered borrower] customers.”²⁶ However, we believe the Department can achieve this goal without depriving servicemembers and their families of options to reduce their lending costs.

- **Proposed Solution:** Amend § 232.8(f) as follows:

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. In addition, this paragraph shall not apply to a transaction for which the creditor uses the title of a vehicle as security for the obligation involving the consumer credit if the creditor extends consumer credit to a covered borrower under more favorable terms to the covered borrower, such as a lower MAPR.

²³ 80 Fed. Reg. at 43590.

²⁴ *Id.*

²⁵ 72 Fed. Reg. at 50594.

²⁶ 80 Fed. Reg. at 43589-90.

VI. Covered Borrower Determination: *Timing of Safe Harbor Covered Borrower Search*

- **Background:** Section 232.5(b)(3) requires that to enjoy the safe harbor, creditors must verify military status “solely at the time -- (i) a consumer *initiates* the transaction or 30 days prior to that time; (ii) a consumer *applies* to establish the account or 30 days prior to that time; or (iii) the creditor *develops or processes*, with respect to a consumer, a firm offer of credit that . . . includes the status of the consumer as a covered borrower” (Emphasis added.)
- **Issues:** There are two main issues that arise with this approach:

Issue 1: Timing of consumer reports. Because the wording of the MLA Regulation is unclear, one could read the MLA Regulation as suggesting that, if the creditor verifies military status *after* application and before the account is opened, it does not enjoy the safe harbor. As creditors work to operationalize these rules for issuing credit to individuals in real world situations, verifying military status at the time of application – whether through a consumer report or the DMDC website – is not always possible, practical, or efficient.

Issue 2: Batch searching and the DMDC MLA database. Limiting the safe harbor to inquiries made at the time of application or prior to application causes problems for creditors batching inquiries to the Department of Defense Manpower Data Center MLA database (“DMDC MLA database”). The DMDC MLA database can be searched “instantly” by manually entering each applicant’s last name and Social Security number (“SSN”) twice. This process requires having an applicant’s SSN, internet access, and a way to save the search results. The DMDC MLA database can also be batch-searched by uploading a specially-formatted file with this information. However, this batch searching process requires overnight processing and cannot be used as a covered borrower check for instant credit decisions. As a result, this process is really only useful for credit extensions akin to a prescreened offer of credit. Alternatively, creditors may obtain military status information from a consumer report, but this option requires an existing relationship with a consumer reporting agency and, unlike the DMDC MLA database, paying a fee.²⁷

While creditors appreciate having the choice of either the DMDC MLA database or the consumer report check, the timing requirements for the safe harbor search often prevent creditors from using the free DMDC MLA database, which requires them to pay for the information. For example, small creditors that offer online/instant credit find it particularly difficult to use the DMDC MLA database because it requires manual

²⁷ In addition, the DMDC MLA database is often down due to technical issues. While this is less of an issue with the DMDC SCRA database, the SCRA database is used in a servicing context where waiting a few days to conduct a new DMDC search is usually not a problem. Because the MLA addresses the extension of credit, however, a creditor needs to be able to tell a customer at that moment whether he/she qualifies for credit. In today’s competitive market, such a delay is not an option.

intervention that can prevent an “instant” decision. This forces them to pay extra money for a consumer reporting agency check that in most instances will show that the applicant is not a covered borrower. For point of sale credit, this issue is even more pronounced as a clerk must make the search immediately. A clerk may not have internet access or the ability to save the results of the inquiry. In addition, such DMDC checks would complicate the training and transaction process at checkout. The application must be denied if the database is unavailable.

- **Proposed Solution:** Amend § 232.5(b)(3) as follows:

Determination and recordkeeping; one-time determination permitted. A creditor who makes a determination regarding the status of a consumer by using one or both of the methods set forth in paragraph (b)(2) of this section shall be deemed to be conclusive with respect to that transaction or account involving consumer credit between the creditor and that consumer, so long as that creditor timely creates and thereafter maintains a record of the information so obtained. A creditor may make the determination described in this paragraph (b), and keep the record of that information obtained at that time, solely at the time—

(i) A consumer initiates the transaction or 30 days prior to that time;

(ii) A consumer applies to establish the account or 30 days prior to that time; ~~or~~

(iii) Before funding of a closed-end credit transaction or before the consumer makes the initial transaction on an open-end credit plan, provided, however, that the creditor provides the disclosures required by § 232.6 no later than the end of the first complete billing cycle or equivalent period following the determination that the consumer is a covered borrower;

(iv) Within 14 days of the establishment of an open-end credit plan at point of sale, in person, over the phone, or over the internet, provided, however, that no later than the end of the first complete billing cycle following the determination that the consumer is a covered borrower, the creditor provides the disclosures required by § 232.6 and, if the consumer is a covered borrower, makes any refunds or adjustments to the account necessary to comply with this part; or

(v) The creditor develops or processes, with respect to a consumer, a firm offer of credit that (among the criteria used by the creditor for the offer) includes the status of the consumer as a covered borrower, so long as the consumer responds to that offer not later than 60 days after the time that the creditor had provided that offer to the consumer. If the consumer responds to the creditor's offer later than 60 days after the time that the creditor had provided that offer to the consumer, then the creditor may not rely upon its initial determination in developing or processing that offer, and, instead, may act on the consumer's response as if the consumer is initiating the transaction or applying to establish the account (as described in paragraph (b)(3)(i) or (ii) of this section).

VII. Covered Borrower Determination: *Direct Connect to DMDC Database*

- **Background:** The Department has worked with certain institutions to set up a pilot program to directly connect to the DMDC's database. This Direct Connect program would establish a secure, creditor-to-Department electronic connection allowing an instant, free determination of whether an individual is a covered borrower that complies with the MLA safe harbor.
- **Issue:** The Trade Associations are concerned that the Direct Connect option is not yet active. Currently this is an issue as there is no way to obtain an instant, free MLA safe harbor search other than through a one-off manual search of the DMDC database. However, this will become particularly significant when all credit card issuers are subject to the MLA, as the number of prescreened offers of credit and credit cards applications will likely dwarf the current volume of DMDC covered borrower searches.
- **Proposed Solution:** We request that the Department commit the necessary resources to fully implement the Direct Connect option no later than October 3, 2017.

VIII. Oral Disclosures – Calling Borrowers

- **Background:** Section 232.6(d)(2)(ii) requires a creditor to provide certain oral disclosures “in person” or by offering a covered borrower a “toll-free number” to call to receive the disclosures. Creditors may not, for example, call the customer or provide the disclosures when the customer calls the financial institution on a non-toll free number.
- **Issue:** Creditors of all sizes are finding it difficult to establish an international toll-free number, and we are seeking clarification to confirm that this section was not intended to require creditors to do so. Having an effective way to communicate with covered borrowers internationally is particularly critical for this population, as servicemembers are often stationed overseas. Similarly, getting any telephone access can be challenging in deployments to areas of active combat. Smaller creditors in particular often do not otherwise maintain toll-free numbers and are having to incur the expense of creating and maintaining a toll-free number, which is especially frustrating for financial institutions that rarely, if ever, receive applications from covered borrowers. Allowing creditors to call covered borrowers to provide the oral disclosures or allowing them to provide the disclosures when the customer calls benefits both covered borrowers and the creditors. There is no reason not to permit this flexibility and decrease compliance costs.
- **Proposed Solution:** Amend § 232.6(d)(2)(ii) as follows:

A creditor may satisfy the requirement in paragraph (d)(2)(i) of this section if the creditor provides—

- (A) The information to the covered borrower through any person-to-person oral communication, including but not limited to a conversation with the borrower in person or over the telephone or internet;
- (B) A toll-free telephone number in order to deliver the oral disclosures to a covered borrower when the covered borrower contacts the creditor for this purpose; or
- (C) A recorded message left by the creditor at the telephone number provided by the borrower, that includes the information required in paragraphs (a)(1) and (a)(3) of this section.

IX. MAPR Calculation: *Inaccurate calculation of MAPR for annual fees for open-end loans*

- **Background:** For purposes of calculating the MAPR (which is not disclosed to the consumer), the supplementary information accompanying the final MLA Regulation suggests that an *annual* fee should be multiplied by 12 during the month in which it is incurred:

For example, suppose a creditor offers a line of credit to a covered borrower . . . (commonly referred to as a “personal line of credit”), and permits the borrower to repay on a monthly basis. Upon establishing the personal line of credit, the covered borrower borrows \$500. The creditor charges a periodic rate of 0.006875 (which corresponds to an annual rate of 8.25 percent), plus a fee of \$25, charged when the account is established and *annually thereafter*. Under these circumstances, pursuant to § 1026.14(c)(2) of Regulation Z the creditor would calculate the MAPR as follows: “dividing the *total amount* of the finance charge for the billing cycle”—which is \$3.44 (corresponding to $0.006875 \times (\$500)$), *plus* \$25—“by the amount of the balance to which it is applicable”—\$500—and *multiplying the quotient* (expressed as a percentage) *by the number of billing cycles in a year*”—12 (since the creditor allows the borrower to repay monthly), which is 68.26 percent. In this example, even though the periodic rate (0.006875) would comply with the interest-rate limit under § 232.4(b), the resultant MAPR would be in excess of that limit because the amount borrowed is low at the time the annual fee is imposed. If the covered borrower instead borrows a higher amount, then the creditor still could impose the \$25 annual fee and comply with § 232.4(b); for example, if the amount initially borrowed is \$1,400, then the resultant MAPR would be 24.73, well below the 36 percent limit.²⁸

²⁸ 80 Fed. Reg. 43560, 43583 (July 22, 2015) (emphasis added).

- **Issue:** Treating a fee imposed once a year as though it is imposed 12 times per year is simply an inaccurate calculation method, is inconsistent with the MLA Regulation and the Truth in Lending Act’s Regulation Z that the MLA Regulation references, and leads to incorrect results. An *annual* fee covers the cost of providing a consumer with an open-end plan for *a year*. Thus, the MAPR would be more accurate if 1/12th of the fee were included in the MAPR calculation for each monthly billing cycle.
- **Proposed Solution:** Amend § 232.4(c)(1)(iii)(C) as follows:

Except as otherwise provided in paragraph (c)(2)(ii)(B) of this section, any fee imposed for participation in any plan or arrangement for consumer credit, provided that, if such fee is charged to a consumer on a less frequent basis than monthly, the fee shall be divided such that it is treated as if incurred on a monthly basis during the applicable period for the fee. For example, an annual fee would be divided by 12 for purposes of calculating the MAPR, while a semi-annual fee would be divided by 6 for purposes of calculating the MAPR.

In the preamble to the amended rule, restate the example provided in the preamble to the 2015 final rule as follows:

For example, suppose a creditor offers a line of credit to a covered borrower primarily for personal, family, or household purposes (commonly referred to as a “personal line of credit”), and permits the borrower to repay on a monthly basis. Upon establishing the personal line of credit, the covered borrower borrows \$500. The creditor charges a periodic rate of 0.006875 (which corresponds to an annual rate of 8.25 percent), plus a fee of \$25, charged when the account is established and annually thereafter. Under these circumstances, pursuant to § 1026.14(c)(2) of Regulation Z the creditor would calculate the MAPR as follows: “dividing the total amount of the finance charge for the billing cycle”—which is \$3.44 (corresponding to $(0.006875) \times (\$500)$), plus ~~\$25~~ the portion of the \$25 annual fee attributable to that billing cycle ($\$25$ divided by 12, or $\$2.08$)—“by the amount of the balance to which it is applicable”—\$500—and multiplying the quotient (expressed as a percentage) by the number of billing cycles in a year”—12 (since the creditor allows the borrower to repay monthly), which is ~~68.26~~ 13.25 percent. In this example, the MAPR would comply with the 36 percent limit; however, the creditor would need to add \$2.08 to every monthly finance charge for every month during the year when the creditor charged the annual fee.

X. MAPR Calculation: *Calculation of MAPR if \$0 Balance During a Billing Cycle*

- **Background:** Section 232.4(c)(2)(ii)(B) provides that no fees that are included in the MAPR calculation may be charged in billing cycles with no balance except for a participation fee that is \$100 or less. For credit cards, a fee greater than \$100 may be charged if it is a bona fide fee that is reasonable.

- **Issue:** This provision leaves a “donut hole” where a participation fee up to \$100 is permitted if there is no balance in the cycle; however, if there is a small balance, a participation fee of \$100 would exceed the 36% MAPR cap and could not be charged. In addition, if there is a large balance, the \$100 would likely fall within the 36% MAPR, and could be charged. In other words, if a customer does not use an account during a cycle, the fee up to \$100 could be charged. And, if a customer uses an account for significant transactions, a fee up to \$100 could also be assessed. However, if a customer only uses the account a little, a fee could not be assessed if it would exceed the 36% MAPR cap. This provision was intended to permit “reasonable” participation fees and address a calculation anomaly for a balance of \$0 in a billing cycle—but treats a small balance different from a \$0 balance.
- **Proposed Solution:** Amend § 232.4 (c)(2)(ii)(B) as follows:

No balance during a billing cycle. For open-end credit, if the MAPR cannot be calculated in a billing cycle because there is no balance in the billing cycle, a creditor may not impose any fee or charge during that billing cycle, this limitation does not apply to a bona fide fee imposed in accordance with paragraph (d) of this section.

Create a new § 232.4(d)(3)(iii) that reads:

For open-end credit, a participation fee is a bona fide fee under paragraph (d)(1) so long as the participation fee does not exceed \$100 per annum (to be adjusted by the Department every two years for inflation).

Renumber existing § 232.4 (d)(3)(iii) as new § 232.4 (d)(3)(iv) and amend as follows:

Indicia of reasonableness for a participation fee. An amount of a bona fide fee for participation in a credit card account may be reasonable under paragraph (d)(1) of this section if, notwithstanding paragraph (d)(3)(iii), that amount reasonably corresponds to the credit limit in effect or credit made available when the fee is imposed, to the services offered under the credit card account, or to other factors relating to the credit card account. For example, even if other creditors typically charge \$100 per annum for participation in credit card accounts, a \$400 fee nevertheless may be reasonable if (relative to other accounts carrying participation fees) the credit made available to the covered borrower is significantly higher or additional services or other benefits are offered under that account.

Renumber § 232.4(d)(3)(iv) as § 232.4(d)(3)(v).

XI. MAPR Calculation: *Definition of Ancillary Fees*

- **Background:** Section 232.4(c)(1)(ii) includes in the MAPR calculation “[a]ny 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.”
- **Issue:** Creditors are unsure what a “credit-related ancillary product” is, and some are considering prohibiting covered borrowers from financing any ancillary products as a result. While we understand the concerns raised by regulators regarding the marketing and sale of credit insurance and similar ancillary products, those concerns are best addressed by targeting the objectionable practices (as the Bureau and other agencies have done), not by denying covered borrowers the option to finance certain products they choose to purchase.
- **Proposed Solution:** Add a new § 232.3(i) as follows:

Credit-related ancillary product means any product or service that is sold directly or indirectly by the creditor to a covered borrower as an optional product that, in whole or in part (i) waives, pays, reduces, satisfies, or defers an amount due to a creditor from a covered borrower, or (ii) protects property that secures the credit. Notwithstanding any other provision of this section, the term credit-related ancillary product excludes the following: motor club memberships; accidental death, term life, or other life/accident insurance not related to the debt; extended warranties and mechanical breakdown protection; required collateral protection insurance and other required property coverages; lender-placed coverages upon borrower’s default and/or failure to maintain property insurance; non-file insurance; and similar products, services, and items.

XII. Methods of Access: *Remotely Created Checks*

- **Background:** Section 232.8(e) prohibits using “a check or other method of access to a deposit, savings, or other financial account maintained by the covered borrower.” Q&As 16 and 17 of the Interpretive Rule state that “§ 232.8(e) prohibits a creditor from using the borrower’s account information to create a remotely created check or remotely created payment order in order to collect payments on consumer credit from a covered borrower.”²⁹
- **Issue:** We understand the Department’s concerns regarding the use of remotely credited checks (“RCCs”) in the traditional “payday” context, and we believe that this section of the rule was meant to be limited to that context. For other lenders, RCCs are regularly used to help borrowers make payments automatically and avoid late or missed payments, an important option for servicemembers who did not set up ACH routing prior to an emergency deployment, for example. In addition, servicemembers and their families who

²⁹ 81 Fed. Reg. at 58844-45.

wish to make an immediate payment on an account by providing the account information *at the time they wish to pay* cannot avail themselves of this convenient option. RCCs provide an important alternative in these situations. Thus, to ensure that mainstream lenders do not restrict access to RCCs, the proposed revision seeks to confirm and clarify that this section does not apply in the non-“payday” context.

- **Proposed Solution:** Add a new § 232.8(e)(5) as follows:

If not otherwise prohibited by applicable law, use of a remotely created check or other method to initiate a one-time fund transfer or other transaction immediately after the consumer provides an oral, written, or electronic authorization for the transfer.

[See also the proposed amendment to § 232.8(e)(4) in the following section. The preamble to the amended rule should either restate Q&A 16 and 17 in a manner consistent with the amendments or state that, to the extent Q&A 16 and 17 contradict the amended rule, they should be stricken.]

XIII. Methods of Access: *Right of Setoff*

- **Background:** Section 232.8(e) prohibits using “a check or other method of access to a deposit, savings, or other financial account maintained by the covered borrower.” (Emphasis added.) Consumer credit contracts, as permitted by common law and statute, often include a provision that customers agree that the depository institution may access money in the customers’ deposit accounts for repayment if they do not pay the loan. The provision encourages repayment, lowers loan prices, and helps people qualify for loans.

Q&A 18 of the Interpretative Rule states, “§ 232.8(e) does not impede a creditor from exercising a statutory right to take a *security* interest in funds deposited in an account at any time, provided that the security interest is not otherwise prohibited by applicable law and the creditor complies with the MLA regulation.”³⁰ In addition, earlier in Q&A 18, the Department suggests that the ability to exercise a statutory right to take a security interest may be limited to “certain circumstances [in which] federal or state statutes may grant creditors statutory liens on funds deposited within covered borrowers’ asset accounts.”³¹

- **Issue:** When exercising the right to setoff, depository institutions “access” the customers’ accounts. It is not clear from the regulation and Interpretive Rule whether depository institutions can exercise the right of setoff for covered loans. In drafting § 232.8(e), the Department appears to be focused on depository institutions that require pre-dated checks and mandatory preauthorized transfers prior to extending credit. However, by allowing creditors to take a security interest in funds deposited after the

³⁰ 81 Fed. Reg. at 58845 (emphasis added).

³¹ *Id.*

extension of credit in an account established in connection with the consumer credit transaction, the Department appears to recognize creditors' longstanding rights under state law to take security interests in deposit accounts in order to collect past-due or defaulted obligations.

As drafted, however, § 232.8(e) and Q&A 18 are confusing. In particular, it is unclear whether a depository institution may exercise a common law right of setoff for an unpaid loan or whether it may exercise a statutory right of setoff even if the statute does not grant a "statutory lien" on the funds. If depository institutions cannot exercise a right to setoff, they will be less likely to make certain loans to covered borrowers and/or they will have to increase the cost of credit to offset the risk of this being an unsecured loan. This particularly harms young servicemembers and their families who are trying to build or rebuild credit histories.

Further, as an operational matter, requiring covered borrowers to establish a deposit account at the time the loan is made and requiring creditors to take a security interest only in funds deposited after the account is established is overly burdensome and contradictory to state law and contradicts long-established policies and procedures in the industry. Such a procedure is counter to the Department's apparent intent to allow depositories to take security interests in deposit accounts in order to protect against default, as they always have.

- **Proposed Solution:** Amend § 232.8(e)(3) as follows:

If not otherwise prohibited by law, take a security interest in funds deposited in an account(s) established or designated in connection with the consumer credit transaction.

Add a new § 232.8(e)(4) as follows:

If not otherwise prohibited by applicable law, exercise a right of offset or setoff in funds deposited after the extension of credit.

XIV. Methods of Access: *Liquid-Secured Loans (Loans Secured by a Bank Account)*

- **Background:** Section 232.8(e) prohibits using "a check or other *method of access* to a deposit, savings, or other financial account maintained by the covered borrower." (Emphasis added.) Section 232.8(e)(3) provides an exception to the prohibition against accessing an account and allows such access "if not otherwise prohibited by applicable law, take a security interest in funds deposited *after* the extension of credit in an account established in connection with the consumer credit transaction." (Emphasis added.) In addition, Q&A 18 to the Interpretive Rule states: "Section 232.8(e) does not impede a creditor from exercising a statutory right to take a security interest in funds deposited in an account at any time, *provided that the security interest is not otherwise prohibited by applicable law* and the creditor complies with the MLA Regulation, including the limitation

on the MAPR to 36 percent.”³² Thus, this exception to the prohibition against accessing accounts only applies if the funds securing the loan are deposited *after* the loan is made. Loans secured by a deposit account are useful in helping people, including servicemembers and their families, to build or rebuild credit history.

- **Issue:** In their current form, the MLA Regulation and Interpretive Rule can be read to limit how and whether creditors can extend liquid-secured loans to covered borrowers. The security interest for these products must be taken *no later than the time the account is established*, not *after*, as the MLA Regulation provides. Thus, some lenders have concluded that covered borrowers are not eligible for these valuable products that help to build or rebuild credit history. While Q&A 16-18 to the Interpretive Rule appears to allow depository institutions to make loans that are secured by a borrower’s account, these lenders are concerned that this guidance could be read as contradicting the MLA Regulation itself.

Further, the use of the term “applicable law” could be read to include the MLA, and therefore state that a security interest is allowed under the MLA Regulation, except to the extent it is prohibited by the MLA Regulation. Although we do not believe this is the best reading of the regulation, the lack of clarity has caused some creditors to question whether this language is circular and leaves unresolved whether the MLA Regulation permits creditors to make liquid secured loans to covered borrowers. Thus, the proposed revision seeks to confirm and clarify that this section does not apply to liquid-secured loans.

- **Proposed Solution:** Amend § 232.8(e)(3) as follows:

If not otherwise prohibited by applicable law, take a security interest in funds deposited in an account established or identified as a source of a security interest in connection with the consumer credit transaction, including but not limited to an account held by the creditor.

XV. Resolving Inevitable Compliance Errors: *Cure Provision*

- **Background:** Despite best efforts by creditors to comply with the MLA Regulation, some level of inadvertent errors is inevitable due to system breakdowns, one-off employee mistakes, and similar issues. While a covered borrower should never receive reduced protections as a result of the creditor’s error, it is vital that the regulation establish a rational process for resolving these errors so that responsible creditors have the proper incentives to self-identify errors and make covered borrowers whole.

Section 232.9(e)(4) states that “a person may not be held liable for civil liability . . . if the person shows by a preponderance of evidence that the violation was not intentional and

³² *Id.* at 58844-45 (emphasis added).

resulted from a bona fide error notwithstanding the maintenance of procedures reasonably adapted to avoid any such error.”

- **Issue:** While this provision is helpful, it encourages the creditor to passively wait for covered borrowers to assert a claim rather than actively seek to remedy the error. In contrast, the Truth in Lending Act, from which the MLA Regulation borrows liberally, states:

A creditor or assignee has no liability under this section . . . for any failure to comply with any requirement . . . if within sixty days after discovering an error . . . and prior to the institution of an action under this section or the receipt of written notice of the error from the obligor, the creditor or assignee [1] notifies the person concerned of the error and [2] makes whatever adjustments in the appropriate account are necessary to assure that the person will not be required to pay an amount in excess of the charge actually disclosed, or the dollar equivalent of the annual percentage rate actually disclosed, whichever is lower.³³

- **Proposed Solution:** Create a new § 232.9(f) modeled on section 130(b) of the Truth in Lending Act stating:

Correction of errors. A creditor or assignee has no liability under 10 U.S.C. 987 or this part for any failure to comply with any requirement imposed under 10 U.S.C. 987 or this part, if within sixty days after discovering or being informed of an error and prior to the institution of an action under this section or the receipt of written notice of the error from the obligor, the creditor or assignee: (i) provides a written notice of the error to the covered borrower along with corrected disclosures, if applicable; and (ii) makes whatever adjustments to the account and the credit agreement are necessary to ensure that the covered borrower will not be required to pay any amount or take any action that is inconsistent with 10 U.S.C. 987 and this part.

XVI. Resolving Inevitable Compliance Errors: *Avoidance of the Loan*

- **Background:** Section 232.9(c) states that “[a]ny credit agreement, promissory note, or other contract with a covered borrower that fails to comply with 10 U.S.C. 987 as implemented by this part or which contains one or more provisions prohibited under 10 U.S.C. 987 as implemented by this part is void from the inception of the contract.”
- **Issue:** Avoidance of the contract is a drastic remedy that should be reserved only for the most serious compliance errors. The possibility that an inadvertent error will void the credit agreement discourages responsible institutions from actively extending credit to servicemembers and their families. For some smaller financial institutions that serve areas with significant military populations, the possibility that a large number of loans could be

³³ 15 U.S.C. § 1640(b).

deemed void due to, for example, an inadvertent system error that results in the provision of erroneous disclosures embedded in the agreements could raise safety and soundness concerns about the viability of the institution.

Voiding a contract over a compliance error can also be detrimental to a covered borrower. For example, if the agreement on a Credit Card Account is void, the creditor will cease to extend credit, leaving the borrower without the ability to use the account to manage regular expenses. For servicemembers deployed overseas, this can be a major concern.

By specifically referring to a “credit agreement, promissory note, or other contract with a covered borrower” that “fails to comply” with the statute as implemented, the MLA Regulation appears to only void the contract if the actual language of the credit instrument fails to comply with the MLA. In contrast, other compliance errors would not void the contract. For example, if a creditor makes an error in providing the written or oral disclosures, inadvertently charges an MAPR that exceeds 36% during a billing cycle (for an open-end account), or takes one of the actions prohibited in § 232.8, the creditor should be subject to appropriate liability but avoidance of the contract is not warranted. There is ample opportunity for the creditor to remedy such an error in the process of servicing the obligation, such as by providing the disclosures, refunding the overcharge, or ceasing the action under § 232.8.

In addition, its August 2016 Interpretive Rule, the Department has acknowledged that a creditor may comply with the MLA by offering a single contract containing one or more terms not permitted by the MLA to all borrowers, so long as the contract contains a “savings clause . . . limiting the application of the proscribed term to only non-covered borrowers, consistent with any other applicable law.”³⁴ To provide both creditors and covered borrowers with necessary clarity, we ask that the Department specifically recognize the use of a savings clause in the Regulation.

- **Proposed Solution:** Amend § 232.9(c) as follows:

Any credit agreement, promissory note, or other contract with a covered borrower that fails to comply with 10 U.S.C. 987 as implemented by this part or which contains one or more provisions prohibited under 10 U.S.C. 987 as implemented by this part is void from the inception of the contract; provided, however, that a failure to comply with §§ 232.4, 232.6, or 232.8 shall not void the contract.

Create a new § 232.9(d) that reads:

Notwithstanding any other provision of this section, a creditor may comply with this part by including a “savings clause” stating that the credit agreement, promissory note, or other contract will not be enforced against a covered borrower to the extent prohibited by this part.

³⁴ 81 Fed. Reg. at 58844.

Renumber § 232.9(d) and (e) as § 232.9(e) and (f), respectively.

XVII. Amendment to Facilitate Responsible Small Dollar Loans for Servicemembers and Their Families

- **Background:** Sections 232.4(c)(2)(i) and (ii) require a creditor to calculate the MAPR by including all fees charged in connection with the extension of credit according to § 232.4(c)(1), including application and participation fees. For open-end credit, the creditor must calculate the MAPR for a billing cycle, which for lines of credit is typically a 30-day period.
- **Issue:** As a result of these MAPR calculation requirements and the 36 percent MAPR cap, mainstream small dollar products are becoming unavailable to servicemembers and their families – or are not made at all because of the cumulative burdens and complications of providing them. Some of those products include modest \$20 to \$35 application fees. These fees are intended to recover some of the fixed costs of origination or of making credit available on an annual basis. When these fees are included in the MAPR, the MAPR can quickly exceed the 36 percent cap. For example, a one-month \$500 loan with a \$20 application fee would reach 48 percent MAPR before interest is included in the calculation, and a \$200 loan a 120 percent MAPR. The MLA Regulation thus lumps these responsible products in with predatory lending products and thereby put them out of reach of servicemembers and their families.

The Department has repeatedly stated that the MLA Regulation must not cause servicemembers and their families to lose access to valuable mainstream loan products.³⁵ However, the MLA Regulation has significantly exacerbated the already difficult challenges our members face in offering affordable small-dollar loans – even as regulators, including the FDIC and the CFPB, encourage financial institutions to offer small-dollar affordable loans.³⁶ The MAPR cap, coupled with economic practicalities,

³⁵ 79 Fed. Reg. at 58604.

³⁶ The FDIC's 2007 affordable small-dollar loan pilot demonstrates the challenges in making small loans (those up to \$2,000) with a rate cap, even with the additional revenue provided by non-interest fees. Under the FDIC's 2007 Affordable Small-Dollar Loan Guidelines, banks were encouraged to offer affordable small-dollar loans. FDIC, *Affordable Small-Dollar Loan Guidelines* (June 2007), available at: <https://www.fdic.gov/news/news/financial/2007/fi107050a.html>. However, the results of the approximately 30 banks that participated in the FDIC's related affordable small-dollar loan pilot were disappointing. The June 24, 2010 meeting of the FDIC Advisory Committee on Economic Inclusion reported that such loans were not profitable. FDIC staff, in reporting on whether banks can profitably offer small-dollar loans, offered no conclusion that the product could be profitable. *Id.* at 114. The FDIC's report noted that banks in the pilot found that "the interest and fees generated are not always sufficient to achieve robust short-term profitability. Rather, most pilot bankers sought to generate long-term profitability through volume and by using small-dollar loans to cross-sell additional products." FDIC, *A Template for Success: the FDIC's Small-Dollar Loan Pilot Program*, FDIC Quarterly, Vol. 4, No. 2, p. 32 (2010), available at: https://www.fdic.gov/bank/analytical/quarterly/2010_vol4_no2/fdic_quarterly_vol4no2_smalldollar.pdf. Indeed, a few banks in the pilot "focused exclusively on building goodwill and generating an opportunity for favorable Community Reinvestment Act considerations," apparently not expecting the product to be profitable. *Id.*

makes it impossible to offer a less expensive, more manageable alternative to payday loans and title loans – the very products MLA is intended to target.

Congress and federal regulators have already established a method for separating responsible and affordable small dollar credit products from abusive alternatives. In 2009, the Federal Reserve Board, the Office of Thrift Supervision, and the National Credit Union Administration responded to concerns about subprime credit card accounts with low credit limits and high fees (sometimes referred to as “fee harvester” cards) by prohibiting additional fees (other than late fees and similar penalty fees) for a credit card line if fees exceed 25 percent of the total credit line in the first year.³⁷ Congress subsequently codified the 25 percent limit on fees for credit cards in the CARD Act, and it is implemented at 12 C.F.R. § 1026.52(a).

Proposed Solution: Adopt the CARD Act approach by amending § 232.4 to exclude from the MAPR all fees charged at account opening or consummation if these fees do not exceed 25 percent of the credit limit at account opening or the amount of credit at consummation. Covered loans would still be subject to the 36 percent MAPR cap.

Specifically, we recommend that the Department amend § 232.4(c)(1)(iii) as follows, and add a new paragraph (e) to § 232.4 to exclude from the MAPR all fees charged at account opening or consummation if they do not exceed 25 percent of the credit limit at account opening or the amount of credit at consummation.³⁸

(c) Calculation of the MAPR.—(1) Charges included in the MAPR. The charges for the MAPR shall include, as applicable, to the extension of consumer credit:

(iii) Except for a bona fide fee (other than a periodic rate) which may be excluded under paragraph (d) of this section, and fees which may be excluded under paragraph (e) of this section:

(e) Exclusion of fees under 25 percent limit. Fees and charges imposed on any extension of credit shall not be included in the calculations required under

³⁷ See 75 Fed. Reg. 7658, 7724 (Feb. 22, 2010) (“[B]ecause the Board and the other Agencies were concerned that disclosure alone was insufficient to protect consumers from unfair practices regarding high-fee subprime credit cards, the January 2009 FTC Act Rule prohibited institutions from charging certain types of fees during the first year after account opening that, in the aggregate, constituted the majority of the credit limit. In addition, these fees were limited to 25 percent of the initial credit limit in the first billing cycle with any additional amount (up to 50 percent) spread equally over the next five billing cycles.”); see also 74 Fed. Reg. 5498 (Jan. 29, 2009).

³⁸ The 25 percent model was created in the context of credit cards, and a different percentage may be more appropriate for non-credit card accounts. The Trade Associations would welcome an open dialogue with the Department on this issue.

paragraphs (c)(2)(i) and (c)(2)(ii) of this section if the total amount of such fees and charges does not exceed 25 percent of the maximum amount of credit made available to the covered borrower at account opening or consummation, as applicable. Such fees and charges shall be excluded even if the covered borrower does not use the entire amount of available credit.

XVIII. Exemption for Credit Card Accounts

- **Background:** When the Department extended the MLA Regulation to cover Credit Card Accounts, it recognized that, because the MAPR on a Credit Card Account is recalculated each billing cycle, it was necessary to exclude certain standard fees (such as annual fees and cash advance fees) that could push the MAPR well above the 36 percent cap for a given cycle, depending on the account's balance and other charges. The Department attempted to address this issue by creating a category of "bona fide fees" that do not count against the 36% MAPR limitation for Credit Card Accounts opened for covered borrowers.³⁹ Generally, a fee must be "reasonable" to be considered a bona fide fee,⁴⁰ but whether a fee is "reasonable" can be difficult to determine prospectively. Recognizing this, § 232.4(d)(3)(ii) creates a safe harbor for determining whether a particular fee on a Credit Card Account is a bona fide fee:

A bona fide fee is reasonable under paragraph (d)(1) of this section if the amount of the fee is less than or equal to an average amount of a fee for the same or a substantially similar product or service charged by 5 or more creditors each of whose U.S. credit cards in force is at least \$3 billion in an outstanding balance (or at least \$3 billion in loans on U.S. credit card accounts initially extended by the creditor) at any time during the 3-year period preceding the time such average is computed.

If any single fee imposed on a Credit Card Account is deemed not to be a bona fide fee, then *all* fees must be included in the MAPR.

- **Issue:** Unfortunately, while well-intentioned, the Department's initial solution for addressing fees on Credit Card Accounts is proving unworkable. Credit card issuers are facing tremendous uncertainty as to how to determine what are bona fide fees under § 232.4(d)(3)(ii). For example:

Information on fees charged: This information not readily available in securities filings or on the Bureau's website.

³⁹ 32 C.F.R. § 232.4(d).

⁴⁰ *Id.* § 232.4(d)(1).

Substantially similar product: It is difficult to determine what makes two credit products “substantially similar,” especially in instances where the descriptions of individual products offered by other institutions are not readily available.

Fee amounts may vary: Fee structures vary among credit card issuers. For example, one issuer may impose a fee for a service in dollars or a percentage, whichever is higher. Another issuer may have a tiered approach tied to the amount of the transaction, based on dollars or a percentage.

Substantially similar rewards programs: How are creditors to compare rewards programs on, for example, large airlines vs. small airlines? Airline miles v. shopping points at retailers? Merchandise v. cash back v. statement credits?

Fewer than five major credit card issuers: How can creditors have certainty in charging fees or developing new products if all five major credit card issuers do not have the same product?

New and innovative products or services: The safe harbor does not apply if the card issuer is developing a new product or service, because there are no existing products to which the card issuer can make a comparison. This discourages innovations in credit cards that are aimed at helping covered borrowers.

This result is unfortunate and unnecessary for two reasons. First, robust consumer protections for Credit Card Accounts have been in place since 2010 under Regulation Z and the Truth in Lending Act, as amended by the CARD Act. The following summarizes the consumer protections that apply to all Credit Card Accounts, including those provided to servicemembers and their families:

- As discussed above, in the first year a Credit Card Account is open, credit card issuers may not charge account or transaction fees in excess of 25% of the account’s credit limit.
- Credit card issuers are required to submit virtually all of their credit card agreements to the CFPB for posting on its website. In addition, each issuer must prominently post its credit card agreements on its own website.
- All creditors must provide disclosures before the covered borrower becomes obligated, but credit card issuers must provide detailed disclosures before the borrower even applies. Moreover, these early disclosures must be presented in a large, easy-to-read table, which highlights the rates, fees, and other cost information, and is formatted uniformly across all issuers to enable comparison shopping.
- Credit card issuers, like mortgage lenders, have an obligation to review the covered borrower’s income or assets, and existing debts, to determine whether

the covered borrower has an ability to repay the debt before extending credit or increasing the credit limit.

- Credit card issuers are not permitted to issue a credit card to a covered borrower who is under 21 unless the covered borrower files a written application – telephone applications are not permitted – and either demonstrates an independent ability to pay or has an eligible cosigner, guarantor, or joint applicant.
- Credit card issuers are subject to limits on the amount and frequency of late, over limit, and other penalty fees, while other creditors are not. The fees must be reasonable and proportional to the amount of the violation.
- A credit card issuer that offers a low promotional rate or fee to a covered borrower cannot raise that rate or fee for at least six months and must disclose the duration of the promotion and the rate that will apply after the promotional period ends.
- Credit card issuers are subject to a host of other restrictions that are not applicable to most other open-end creditors. For example, issuers generally cannot increase the rate on an existing balance.

Second, likely because of these protections, the Department received no evidence when amending the MLA Regulation that credit cards have been a source of harm for servicemembers and their families. Thus, we believe that Credit Card Accounts should be excluded from the MLA Regulation, provided that the card issuer complies with the CARD Act consumer protections. Of all of the comment letters in response to the Department’s proposed amendments, only one expressed any concern about credit cards, and that letter only discussed the *potential* for high rates and fees. No evidence was provided to support this speculation. In fact, the Bureau has repeatedly found that the CARD Act provisions provide robust protections for consumers without unduly increasing the cost of credit or inappropriately restricting access.⁴¹

- **Proposed Solution:** Amend the regulation to exclude credit cards that comply with Regulation Z’s 25 percent fee cap from the definition of “consumer credit” in § 232.3(f)(1), by adding § 232.3(f)(2)(vi):

(f)(2) *Exceptions.*

(vi) Credit card accounts under an open-end (not home-secured) consumer credit plan, as defined in 12 C.F.R. § 1026.2(a)(15)(ii).

⁴¹ CFPB, *Card Act Report: A review of the impact of the CARD Act on the consumer credit market*, CFPB, p. 4, (Oct. 1, 2013), available at: http://files.consumerfinance.gov/f/201309_cfpb_card-act-report.pdf.

As stated above, because of the impending October 3, 2017 compliance date for Credit Card Accounts, it is critical that the Department use its authority under § 232.13(c)(2) as soon as possible to extend the compliance date to October 3, 2018.

Trade Associations

The **American Bankers Association** is the voice of the nation's \$17 trillion banking industry, which is composed of small, regional and large banks that together employ more than 2 million people, safeguard \$13 trillion in deposits and extend more than \$9 trillion in loans.

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

The **Consumer Bankers Association** is the only national financial trade group focused exclusively on retail banking and personal financial services—banking services geared toward consumers and small businesses. As the recognized voice on retail banking issues, CBA provides leadership, education, research, and federal representation for its members. CBA members include the nation's largest bank holding companies as well as regional and super-community banks that collectively hold two-thirds of the total assets of depository institutions.

The **Credit Union National Association (CUNA)** is the only national association that advocates on behalf of all of America's credit unions, which are owned by more than 110 million consumer members. CUNA, along with its network of affiliated state credit union leagues, delivers unwavering advocacy, continuous professional growth and operational confidence to protect the best interests of all credit unions.

The **Independent Community Bankers of America®**, the nation's voice for more than 5,800 community banks of all sizes and charter types, is dedicated exclusively to representing the interests of the community banking industry and its membership through effective advocacy, best-in-class education and high-quality products and services. With 52,000 locations nationwide, community banks employ 760,000 Americans, hold \$4.7 trillion in assets, \$3.7 trillion in deposits, and \$3.2 trillion in loans to consumers, small businesses, and the agricultural community. For more information, visit ICBA's website at www.icba.org.

The **National Association of Federally-Insured Credit Unions (NAFCU)** is a direct membership association for federally insured credit unions. We are committed to representing, assisting, educating and informing our member credit unions to help them grow, and help grow the credit union industry.