



3138 10th Street North
Arlington, VA 22201-2149
703.842.2234 | 800.336.4644
f: 703.522.0594
chunt@nafcu.org | nafcu.org

Carrie R. Hunt
Executive Vice President of Government Affairs
and General Counsel

National Association of Federally-Insured Credit Unions

May 25, 2017

Mr. Anthony M. Kurta
Performing the Duties Under Secretary of Defense for Personnel and Readiness
U.S. Department of Defense
4000 Defense Pentagon
Washington, D.C. 20301

RE: Request for Military Lending Act Clarification & FAQ Language

Dear Mr. Kurta:

On behalf of the National Association of Federally-Insured Credit Unions (NAFCU), the only national trade association focusing exclusively on federal issues affecting the nation's federally-insured credit unions, I am writing to you regarding the Military Lending Act (MLA) Rule.

General Comments

As we have previously expressed to the Department of Defense (Department) on several occasions, credit unions have undertaken considerable efforts to comply with the MLA Rule, and they will continue to do so. However, the challenges presented by the MLA Rule are substantial and many financial institutions continue to struggle to determine the parameters of the rule due to ambiguous text and slim guidance.

Credit unions, as member-owned, not-for-profit cooperatives, consistently provide their members with products and services designed to help each member achieve their individual financial goals. In addition, credit unions have a strong track record of helping active duty members of the armed forces and their families avoid the kinds of debt traps that prompted the passage of the MLA by Congress. That is why NAFCU and our members support the Department's primary goal of protecting active duty members of the armed forces and their families from financial exploitation. However, implementing the MLA Rule has proven to be a difficult undertaking for many credit unions. To assist the regulatory process, NAFCU would like to highlight nine specific issues for the Department to consider and address. In addition, we have also prepared draft "Frequently Asked Questions" (FAQs) with suggested answers that correspond to the issues identified.

Common MLA Compliance Difficulties

Although this is by no means intended to be a comprehensive list of challenges, the nine issues identified below are common MLA "pain points" for many credit unions.

1) Co-Borrowers

The MLA mandates that required disclosures be provided before or at obligation. 32 C.F.R. § 232.6(a). Regulation Z allows lenders to provide required disclosures to one borrower before the loan is consummated. 12 C.F.R. § 1026.5(d)(2). As the MLA regulations do not, clarifications incorporating Regulation Z-like flexibility would be helpful. As an example, this clarification would enable lenders to release loan funds where co-borrowers are not located in the same area, such as an active duty service member who is deployed overseas away from his/her spouse. See Proposed FAQ #1.

2) Negative Equity

A purchase money transaction, including a transaction secured by a vehicle, is expressly exempted from the scope of the MLA. 32 C.F.R. § 232.3(f)(2)(ii) and (iii). The DoD's Interpretive Rule addressed purchase money transactions secured by other-than automobiles. It provides that a "hybrid purchase money and cash advance loan" where the "additional financing . . . is unrelated to the purchase . . ." is not eligible for the exemption, and is therefore covered by the MLA. Although this guidance is not about the auto exception, there's confusion about the effect of the guidance on the automobile exception. The DoD should clarify that the financing of amounts other than the vehicle itself—such as title, tag, taxes, a warranty, or the financing of negative equity (such as "trade-in")— is related to the purchase of the vehicle and therefore exempt from MLA coverage. See Proposed FAQ #2.

3) Share- and certificate- secured loans

The MLA regulations allow creditors to establish a security interest in funds deposited in a separate account when those funds are deposited after the loan is extended. 32 C.F.R. § 232.8(e)(3). This provision of the regulation could be interpreted, when read strictly, to prohibit creditors from extending a secured loan to a covered borrower where the funds were deposited into an account before the loan is extended. Under this interpretation, certain products that credit unions offer, such as share- and certificate- secured loans, would not be available to a "covered borrower." However, it is our understanding that this was not the DoD's intent. Accordingly, the DoD should clarify that these loans, as offered and extended by federal credit unions, would not fall under the § 232.8(e)(3) prohibition. See Proposed FAQ #3.

4) Loan Modifications

The MLA regulations apply to a "consumer credit" extended to a consumer who is a "covered borrower" or a "dependent" of a covered borrower at the time of the transaction. 32 C.F.R. § 232.3(f)(1). A "refinancing" is a covered "consumer credit." However, the extent to which, if any, loan modifications are covered is unclear. In most cases, these modifications are made pursuant to a borrower's request. For example, a borrower may add a debt suspension or cancellation product several months into a loan term. Or, a borrower may extend or reduce the maturity date of a loan. In these situations, unlike refinancings, a new loan is not extended. The

DoD should confirm that an event that modifies a loan, and is not a refinancing under Regulation Z, does not trigger the MLA requirements. *See Proposed FAQ #4.*

5) *Bona Fide Fee Safe Harbor*

Under the MLA regulations, a creditor may exclude a “bona fide fee” if the fee is reasonable, which can be determined by comparing the “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.” 32 C.F.R. § 232.4(d)(3)(ii). The regulation, however, is silent about how often the comparison analysis must be conducted. Specificity about how often the comparison analysis must be conducted would be helpful. *See Proposed FAQ #5.*

6) *Covered Borrower Safe Harbor*

The MLA regulations provide a safe harbor for assessing covered borrower status if the borrower’s status is searched on the Department of Defense database or if a consumer report from a nationwide consumer reporting agency is used. 32 C.F.R. § 232.5(b)(2)(i) and (ii). There are circumstances, however, where the search yields an incorrect or inconclusive response. The DoD should clarify that the safe harbor applies to those circumstances. *See Proposed FAQ #6.*

7) *Timing of Covered Borrower Search*

The MLA regulations provide a safe harbor for lenders who perform a “covered borrower” search using one of the prescribed methods at the time a consumer “initiates the transaction or 30 days prior to that time[.]” 32 C.F.R. § 232.5(b)(3)(i). It is unclear, however, when exactly a transaction is “initiated” for purposes of conducting the search to obtain the benefits of the safe harbor, as the term is not defined in the MLA regulations or in Regulation Z. As no “transaction” can be initiated until the application is approved, it appears that the timing requirement would be satisfied when a creditor conducts the check after the loan is approved but before the borrower is “obligated.” The DoD should clarify the timing requirement, and thereby confirm this interpretation. *See Proposed FAQ #7.*

8) *Prohibition on “Onerous Legal Notice” or “Unreasonable Notice”*

The MLA regulations prohibit creditors from imposing “onerous legal notice provisions in the case of a dispute,” 32 C.F.R. § 232.8(c), or demanding “unreasonable notice from the covered borrower as a condition for legal action,” 32 C.F.R. § 232.8(d). The regulations, however, do not define these terms or provide any guidance as to how to interpret them. Indeed, it is unclear what the difference is, if any, between “onerous legal notice” and “unreasonable notice.” The lack of clear standards for lenders to follow is likely to create significant confusion for borrowers and undue risk for lenders. The DoD should provide additional guidance to clarify what type of notice provisions would be considered “onerous” or “unreasonable.” The DoD could provide

needed clarity to these provisions by providing specific examples of notice provisions that would run afoul of the regulations, as well as notice provisions that would be compliant.

9) Prohibition on Waiver of Right to Legal Recourse

Section 232.8(b) of the MLA regulations prohibits a creditor from requiring a covered borrower to “waive the . . . right to legal recourse under any otherwise applicable provision of State or Federal law, including any provision of the Servicemembers Civil Relief Act” 32 C.F.R. § 232.8(b). We believe that this provision is intended to bar the waiver of substantive protections provided under state or federal consumer protection laws or causes of action, and that it does not apply to waivers of commercial or procedural rights. The lack of clarity in the provision, however, is making it difficult for lenders to draft contracts for use with covered borrowers. To address this issue, we request that the DoD provide additional clarity as to the meaning of the term “right to legal recourse,” such as by defining the term or providing specific examples of the types of rights that it considers to be a “right to legal recourse.”

Proposed FAQs

NAFCU would like to offer the following proposed FAQs for the Department's consideration. We believe the Department's adoption of these FAQs would go a long way toward providing credit unions with substantive clarification and ease uncertainty surrounding the MLA Rule.

- 1. When more than one covered borrower is obligated on a loan, can a creditor provide the required disclosures to one co-borrower?*

Answer: Yes. Although the MLA regulations do not specifically address the disclosure requirements where more than one borrower becomes obligated, Regulation Z allows creditors to provide required disclosures to “any consumer who is primarily liable on the account.” 12 C.F.R. § 1026.5(d)(2). Thus, where more than one covered borrower becomes obligated on a covered loan, providing the required disclosures to only one covered borrower would meet the MLA disclosure requirements.

- 2. Does the exemption for a loan secured by vehicles include situations where the loan finances amounts in addition to the vehicle?*

Answer: Yes. The financing of amounts other than the vehicle itself—such as title, tag, taxes, a warranty, or the financing of negative equity (such as a “trade-in”)—is related to the purchase of the vehicle and therefore exempt from MLA coverage.

- 3. Does the prohibition against taking a security interest prohibit all creditors from extending to a “covered borrower” a loan that is secured by deposits in the borrower’s deposit accounts?*

Answer: Although the general prohibition is against extending loans to a covered borrower where a security interest is taken on deposits made prior to the obligation, it is not the intent of the prohibition to limit the availability of established products that have proven to be

helpful to consumers. Therefore, this prohibition does not apply to certain secured loans, such as share- and certificate- secured loans offered and extended by federal credit unions.

4. *Does a modification event trigger MLA requirements?*

Answer: An event that modifies a loan, and is not a refinancing under Regulation Z, does not trigger MLA requirements.

5. *To exclude a fee from the calculation of a MAPR, the fee must be a “bona fide fee.” A fee is “bona fide” if it is reasonable, which can be determined by comparing the “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.” 32 C.F.R. § 232.4(d)(3)(ii). How frequently must the creditor conduct the comparison analysis?*

Answer: A comparison analysis conducted at least once every three years would be adequate to maintain “bona fide” status of a fee.

6. *The MLA regulations provide a safe harbor for assessing a covered borrower status if the borrower’s status is searched on the Department of Defense (DoD) database or if a consumer report from a nationwide consumer reporting agency is used. 32 C.F.R. § 232.5(b)(2)(i) and (ii). Does this safe harbor extend to situations where the search yields an erroneous result?*

Answer: Yes. A creditor’s use of the DoD database or a consumer report would fall within the safe harbor even if the search yields an erroneous result.

7. *The MLA regulations provide a safe harbor for lenders who perform a “covered borrower” search using either the DoD database or a consumer report at the time a consumer “initiates the transaction or 30 days prior to that time[.]” 32 C.F.R. § 232.5(b)(3)(i). Can a creditor rely upon the safe harbor if it conducts the search after the loan is approved but before the member is “obligated”?*

Answer: Yes. The safe harbor applies as long as the search occurs before the borrower is obligated.

Credit Card Deadline Extension

NAFCU has, on several occasions, requested the DoD exercise its authority under Section 232.13(c)(2) of the MLA Rule and issue an order extending the limited exemption for credit card accounts until October 3, 2018. NAFCU believes that extending the deadline for credit card account compliance with the MLA Rule is necessary to allow the DoD additional time to consider the consequences of the MLA Rule as applied to credit card accounts, and to develop effective solutions to prevent those consequences from taking place. Given that we are merely months from the current credit card implementation deadline, it is imperative the DoD act quickly and provide relief to the industry.

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Conclusion

NAFCU and our members recognize MLA serves an important purpose in protecting those who protect us. We look forward to continuing our work with the DoD to ensure credit unions are able to continue providing their members high-quality financial services and products. Should you have any questions or if you would like to discuss these issues further, please feel free to contact me or Alexander Monterrubio, NAFCU's Director of Regulatory Affairs, at (703) 842-2244 or amonterrubio@nafcu.org.

Sincerely,



Carrie R. Hunt

EVP of Government Affairs and General Counsel

CC:

Dr. Elizabeth P. Van Winkle, Principal Director, Force Resiliency, Performing the Duties of the Assistant Secretary of Defense (Readiness)

Andrew H. Cohen, Military Lending Act Manager