

Insights

The Department of Defense Issues an "Interpretative Rule" to the Military Lending Act - Auto and Personal Property Lenders Faced With Regulatory Uncertainty

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Financial institutions offering purchase money auto and personal property loans received an unwanted holiday surprise from the Department of Defense (the "DoD" or the "Department"), with the December 14, 2017 "Interpretative Rule" (the "2017 Interpretative Rule") to the Military Lending Act (the "MLA" or the "Act"). Contrary to its title, the 2017 Interpretative Rule is more a substantive rulemaking than mere interpretation, at least with respect to purchase money auto and personal property loans involving ancillary insurance products.

Following the MLA's enactment in October of 2006,¹ the DoD issued their Final Rule on Limitations on Terms of Consumer Credit Extended to Service Members and Dependents (the "MLA Regulation").² The DoD took a measured approach in their development of the MLA Regulation, limiting its scope to payday loans of 91 days or less, and vehicle title loans of 181 days or less. The MLA Regulation, consistent with the language in the MLA,³ provides an explicit exemption from the definition of "consumer credit" for any credit transaction used to finance "the purchase of a motor vehicle when the credit is secured by the vehicle being purchased" or "the purchase of personal property when the credit is being secured by the property being financed."⁴ Financial institutions, in reliance on these provisions, exclude purchase money auto and personal property loans from the scope of their MLA compliance process, regardless of whether the loans contain GAP or ancillary insurance products. The 2015 amendment to the MLA Regulation retained these exemptions. As required, both iterations of the MLA Regulation followed the notice and comment requirements of the Administrative Procedures Act.⁵

In August of 2016, the DoD provided additional guidance following its 2015 revision to the MLA Regulation, by publishing an Interpretative Rule (the "2016 Interpretative Rule") using a Question and Answer format. The 2017 Interpretative Rule is presented in the same format. Neither the 2016 Interpretative Rule nor the 2017 Interpretative Rule, followed the notice and comment requirements of the Administrative Procedures Act.

The 2017 Interpretative Rule poses the following question with respect to the scope of the definition of "consumer credit" that should be particularly concerning to auto and personal property lenders:

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

Answer: The answer will depend on what the credit beyond the purchase price of the motor vehicle or personal property is used to finance. Generally, financing costs related to the object securing the credit will not disqualify the transaction from the exceptions, but financing credit-related costs will disqualify the transaction from the exceptions. Section 232.3(f)(2) provides a list of exceptions to paragraph (f)(1), including an exception for any credit transaction that is expressly intended to finance the purchase of a motor vehicle when the credit is secured by the vehicle being purchased and an exception for any credit transaction that is expressly intended to finance the purchase of personal property when the credit is secured by the property being purchased. A credit transaction that finances the object itself, as well as any costs expressly related to that object, is covered by the exceptions in § 232.3(f)(2)(ii) and (iii), provided it does not also finance any credit-related product or service. For example, a credit transaction that finances the purchase of a motor vehicle (and is secured by that vehicle), and also finances optional leather seats within that vehicle and an extended warranty for service of that vehicle is eligible for the exception under § 232.3(f)(2)(ii). Similarly, a credit transaction that finances the purchase of an appliance (and is secured by that appliance), and also finances the delivery and installation of that appliance, is eligible for the exception under § 232.3(f)(2)(iii). ***In contrast, a credit transaction that also finances a credit-related product or service rather than a product or service expressly related to the motor vehicle or personal property is not eligible for the exceptions under § 232.3(f)(2)(ii) and (iii). For example, a credit transaction that includes financing for Guaranteed Auto Protection insurance or a credit insurance premium would not qualify for the exception under § 232.3(f)(2)(ii) or (iii).*** (emphasis added)

The consequences of the DoD's "interpretation" are far reaching. Arguably, every purchase money auto or personal property loan extended since the MLA's effective date that contained an ancillary insurance product is, according to the 2017 Interpretive Rule, subject to the MLA. Given the inclusion of any credit insurance premiums, or credit-related ancillary products, in the definition of the Military Annual Percentage Rate, it is possible that some previously thought to be exempt loans, may be, albeit unintentionally, in violation of the MLA. The MLA's inclusion of assignees within the definition of a creditor⁶ further compounds the impact of the 2017 Interpretive Rule.

Financial Institutions that have originated, or been assigned, purchase money auto or personal property loans since the Act's enactment should review their portfolios to identify any loans that may have been made to a covered

borrower, and confirm their compliance with the MLA. Lenders offering purchase money auto or personal property loans prospectively should modify their purchase money auto or personal property loan products to comply with the MLA.

The financial services industry will undoubtedly lobby the DoD to rescind the 2017 Interpretative Rule as quickly as possible; however, the likelihood of the DoD doing so is difficult to predict. In the interim, lenders must address the regulatory mess the 2017 Interpretative Rule has created.

Members of the **Krieg DeVault Financial Institutions Practice Group** are closely monitoring developments with respect to the 2017 Interpretative Rule, and are able to offer counsel should you need assistance in compliance with the MLA.

¹ Public Law 109-364, the John Warner National Defense Authorization Act for Fiscal Year 2007, section 670, "Limitations on Terms of Consumer Credit Extended to Service Members and Dependents" (October 17, 2006).

² 32 C.F.R. § 232

³ 10 U.S.C.A. § 987(i)(6)

⁴ 32 C.F.R. § 232.3(f)(2)(ii)

⁵ 5 U.S.C.A. § 551 et seq. (1946)

⁶ 10 U.S.C.A. § 987(i)(5) Creditor.—The term "creditor" means a person— (A) who— (i) is engaged in the business of extending consumer credit; and (ii) meets such additional criteria as are specified for such purpose in regulations prescribed under this section; or (B) who is an assignee of a person described in subparagraph (A) with respect to any consumer credit extended.