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DEPARTMENT OF DEFENSE

Office of the Secretary

32 CFR Part 232

[Docket ID: DOD-2017-OS-0038]

RIN 0790-ZA13

Military Lending Act Limitations on Terms of Consumer Credit Extended to Service Members and Dependents

AGENCY: Under Secretary of Defense for Personnel and Readiness, Department of Defense.

ACTION: Interpretive rule; amendment.

SUMMARY: The Department of Defense (Department) is amending its interpretive rule for the Military Lending Act (the MLA). The MLA, as implemented by the Department, limits the military annual percentage rate (MAPR) that a creditor may charge to a maximum of 36 percent, requires certain disclosures, and provides other substantive consumer protections on “consumer credit” extended to Service members and their families. On July 22, 2015, the Department amended its regulation primarily for the purpose of extending the protections of the MLA to a broader range of closed-end and open-end credit products (the July 2015 Final Rule). On August 26, 2016, the Department issued the first set of interpretations of that regulation in the form of questions and answers; the present interpretive rule amends and adds to those questions and answers to provide guidance on certain questions the Department has received regarding compliance with the July 2015 Final Rule.

DATES: *Effective Date:* This interpretive rule is effective [INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER].

FOR FURTHER INFORMATION CONTACT: Andrew Cohen, 703-692-5286.

SUPPLEMENTARY INFORMATION:

I. Background and Purpose

In July 2015, the Department of Defense (Department) issued a final rule¹ (July 2015 Final Rule) amending its regulation implementing the Military Lending Act (MLA)² primarily for the purpose of extending the protections of the MLA to a broader range of closed-end and open-end credit products, rather than the limited credit products that had been defined as “consumer credit.”³ Among other amendments, the July 2015 Final Rule modified provisions relating to the optional mechanism a creditor may use when assessing whether a consumer is a “covered borrower,” modified the disclosures that a creditor must provide to a covered borrower, and implemented the enforcement provisions of the MLA.

Subsequently, the Department received requests to clarify its interpretation of points raised in the July 2015 Final Rule. The Department elected to inform the public of its views by issuing an interpretive rule in the form of questions and answers to assist industry in complying with the July 2015 Final Rule. The Department issued the first set of such interpretations on August 26, 2016 (August 26, 2016 Interpretive Rule).⁴ The present interpretive rule amends and adds to those questions and answers. This interpretive rule does not change the regulation implementing the MLA, but merely states

¹ 80 FR 43560 (July 22, 2015).

² 10 U.S.C. 987.

³ 32 CFR 232.3(b) as implemented in a final rule published at 72 FR 50580 (Aug. 31, 2007).

⁴ 81 FR 58840 (August 26, 2016).

the Department's preexisting interpretations of an existing regulation. Therefore, under 5 U.S.C. 553(b)(A), this rulemaking is exempt from the notice and comment requirements of the Administrative Procedure Act, and, pursuant to 5 U.S.C. 553(d)(2), this rule is effective immediately upon publication in the *Federal Register*.

II. Interpretations of the Department

The following questions and answers represent official interpretations of the Department on issues related to 32 CFR part 232. For ease of reference, the following terms are used throughout this document: MLA refers to the Military Lending Act (codified at 10 U.S.C. 987); MAPR refers to the military annual percentage rate, as defined in 32 CFR 232.3(p).

In order to provide further guidance to industry and the public on the Department's view of its existing regulation, the Department amends its guidance on three questions and provides one additional question and answer. The numbering of this document follows the numbering of the questions and answers provided in the August 26, 2016 Interpretive Rule.

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)(1) defines “consumer credit” as credit offered or extended to a covered borrower primarily for personal, family, or household purposes that is subject to a finance charge or payable by written agreement in more than four installments. Section 232.3(f)(2) provides a list of exceptions to paragraph (f)(1), including an exception for any credit transaction that is expressly intended to finance the purchase of 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). Moreover, if a covered borrower trades in a motor vehicle with negative equity as part of the purchase of another motor vehicle, and the credit transaction to purchase the second vehicle includes financing to repay the credit on the trade-in vehicle, the entire credit transaction is eligible for the exception under § 232.3(f)(2)(ii) because the trade-in of the first motor vehicle is expressly related to the purchase of the second motor vehicle. 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). Similarly, a hybrid purchase money and cash advance credit transaction is not expressly intended to finance the purchase of a motor vehicle or personal property because the credit transaction provides additional financing that is unrelated to the purchase. Therefore, any credit transaction that provides purchase money secured financing of a motor vehicle or personal property along with additional “cashout” financing is not eligible for the exceptions under § 232.3(f)(2)(ii) and (iii) and must comply with the provisions set forth in the MLA regulation.

17. Does the limitation in § 232.8(e) on a creditor using a check or other method of access to a deposit, savings, or other financial account maintained by the covered borrower prohibit the borrower from granting a security interest to a creditor in the covered borrower’s checking, savings or other financial account?

Answer: No. The prohibition in § 232.8(e) does not prohibit covered borrowers from granting a security interest to a creditor in the covered borrower’s checking, savings, or other financial account, provided that it is not otherwise prohibited by other applicable law and the creditor complies with all other provisions of the MLA regulation, including the limitation on the MAPR to 36 percent. As discussed in Question and

Answer #16 of these Interpretations, § 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 or using a post-dated check provided at or around the time credit is extended.

Section 232.8(e)(3) further clarifies that covered borrowers may convey security interests in checking, savings, or other financial accounts by describing a permissible security interest granted by covered borrowers. Borrowers may convey security interests for all types of consumer credit covered by the MLA regulation.

Creditors should also note, however, that 32 CFR 232.7(a) provides that the MLA does not preempt any State or Federal law, rule or regulation to the extent that such law, rule or regulation provides greater protection to covered borrowers than the protections provided by the MLA. For example, although the MLA regulation does not prohibit borrowers from conveying security interests in all types of consumer credit covered by the regulation, including credit card accounts, such accounts may also be subject to other laws, rules and regulations governing offsets and security interests. *See, e.g.*, 12 CFR 1026.12(d).

18. Does the limitation in § 232.8(e) on a creditor using a check or other method of access to a deposit, savings, or other financial account maintained by the covered borrower prohibit a creditor from exercising a statutory right, or a right arising out of a security interest a borrower grants to a creditor, to take a security interest in funds deposited within a covered borrower's account at any time?

Answer: No. In addition to the security interests granted by borrowers to creditors, as discussed in Question and Answer #17 of these Interpretations, above, under

certain circumstances Federal or State statutes may grant creditors statutory liens on funds deposited within covered borrowers' asset accounts. Section 232.8(e) does not prohibit a creditor from exercising rights to take a security interest in funds deposited into a covered borrower's account at any time, including enforcing statutory liens, provided that it is not otherwise prohibited by other applicable law and the creditor complies with all other provisions of the MLA regulation, including the limitation on the MAPR to 36 percent. For example, under 12 U.S.C. 1757(11) Federal credit unions may "enforce a lien upon the shares and dividends of any member, to the extent of any loan made to him and any dues or charges payable by him."

As discussed in Question and Answer #16 of these Interpretations, § 232.8(e) serves to prohibit 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 or using a postdated check provided at or around the time credit is extended. Section 232.8(e)(3) describes a permissible activity under § 232.8(e). However, the fact that § 232.8(e)(3) specifies a particular time when a creditor may take a security interest in funds deposited in an account does not change the general effect of the prohibition in § 232.8(e). Therefore, § 232.8(e) does not impede a creditor from—for example—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 other applicable law and the creditor complies with all other provisions of the MLA regulation, including the limitation on the MAPR to 36 percent.

Creditors may exercise the right to take a security interest in funds deposited into a covered borrower's account in connection with all types of consumer credit covered by

the MLA regulation, including credit card accounts, provided the creditor's actions are not prohibited by other State or Federal law, rule or regulation that provides greater protection to covered borrowers than the protections provided in the MLA. For example, although the MLA regulation does not prohibit borrowers from conveying security interests in all types of consumer credit covered by the regulation, including credit card accounts, such accounts may also be subject to other laws, rules and regulations governing offsets and security interests. *See, e.g.*, 12 CFR 1026.12(d).

20. To qualify for the optional safe harbor under 32 CFR 232.5(b)(3), must the creditor determine the consumer's covered borrower status simultaneously with the consumer's submission of an application for consumer credit or exactly 30 days prior?

Answer: No. Section 232.5(b)(3)(i) and (ii) permit the creditor to qualify for the safe harbor when it makes a timely determination regarding the status of a consumer at the time the consumer either initiates the transaction or submits an application to establish an account, or anytime during a 30-day period of time prior to such action. Therefore, a creditor qualifies for the safe harbor under § 232.5(b) when the qualified covered borrower check that the creditor relies on is conducted at the time a consumer initiates a credit transaction or applies to establish an account, or up to 30 days prior to the action taken by the consumer. Similarly, the timing provisions in § 232.5(b)(3)(i) and (ii) permit a creditor to qualify for the safe harbor when it conducts a qualified covered borrower check simultaneously with the initiation of the transaction or submission of an application by the consumer or during the course of the creditor's processing of that application for consumer credit.

III. Regulatory Impact

Executive Order 12866, “Regulatory Planning and Review” and Executive Order 13563, “Improving Regulation and Regulatory Review”

Executive Orders 13563 and 12866 direct agencies to assess all costs and benefits of available regulatory alternatives and, if regulation is necessary, to select regulatory approaches that maximize net benefits (including potential economic, environmental, public health and safety effects, distributive impacts, and equity). Executive Order 13563 emphasizes the importance of quantifying both costs and benefits, reducing costs, harmonizing rules, and promoting flexibility. It has been determined that this is not a significant rule. This interpretive rule will not have an annual effect of \$100 million or more on the economy, or adversely affect productivity, competition, jobs, the environment, public health or safety, or State or local governments. This rulemaking will not interfere with an action taken or planned by another agency, or raise new legal or policy issues. Finally, this rulemaking will not alter the budgetary impacts of entitlements, grants, user fees, or loan programs or the rights and obligations of recipients of such programs.

This amended interpretive rule does not change the regulation implementing the MLA, but merely states the Department’s preexisting interpretations of an existing regulation. Moreover, the Department’s interpretive views do not further prohibit or limit the sale of credit and ancillary credit-related products beyond any limits that may be set forth in the final rule. For example, under the final rule as issued, the inclusion of ancillary credit products in a hybrid transaction makes the credit transaction ineligible for the exemption from “consumer credit” under 32 CFR 232.3(f)(2)(ii) and (iii). This

amended interpretive rule merely provides guidance on how the rule applies when such products are included in a credit transaction. Neither the final rule nor this amended interpretive rule prohibits the sale of ancillary credit products by the creditor as part of the credit transaction or as a separate transaction, nor does either prohibit a covered borrower from purchasing such products from the creditor or from another source. The Department estimates there remains a variety of venues for creditors to offer ancillary credit products and covered borrowers to acquire such ancillary credit products.

In evaluating any potential economic impact, the Department has consulted with the Consumer Financial Protection Bureau (“Bureau”)⁵ to assess the scope of the market for motor vehicle loans that also provide financing for a credit-related product or service, as such loans would not meet the exception from “consumer credit” in 32 CFR 232.3(f)(2)(ii). Specifically, the Department’s assessment focused on guaranteed asset protection (GAP) and other credit insurance premiums, such as credit life and credit disability insurance, that are financed in connection with a credit transaction expressly intended to purchase a motor vehicle. In conducting its assessment, the Department excluded financing costs that are expressly related to the object being purchased because, as clarified in this interpretive rule, such costs would not prevent an otherwise exempt credit transaction from qualifying for the exemptions from “consumer credit” in 32 CFR 232.3(f)(2)(ii) and (iii).⁶ In assessing the scope of the market, the Department, in consultation with the Bureau, relied on informal surveys and reports regarding the market

⁵ The Bureau monitors, analyzes, and performs outreach to the auto lending industry through its Office of Consumer Lending, Reporting & Collection Markets. The Bureau, as part of its ongoing assistance to the Department, provided the Department with certain data regarding the auto lending marketplace.

⁶ For example, the Department excluded from this analysis credit transactions that also finance extended warranty protection or include financing to repay the credit on a trade-in vehicle because the Department interprets such costs as expressly related to the object (motor vehicle) being financed.

for financed motor vehicle transactions, the utilization of GAP and other credit insurance premiums in that market, and the typical costs to consumers associated with such ancillary credit-related products.⁷

Based on available data, the Department estimates the annual total market revenue for these products at \$6,116.5 and \$3,761.7 million, respectively, or a total of \$9,878.1 million. The Department estimates that the covered borrower market for these products is .95 percent of the total market for these products, as covered borrower households represent .95 percent of total U.S. households, which implies a total possible market for covered borrowers of approximately \$93.8 million. Of these covered borrowers, the Department estimates that only a very small portion of these consumers could include the Service members and their families covered by the MLA. As an example, if the typical consumer of such a product is an enlisted Service member under 25, does not have a college degree, and owns a car, the possible market value relevant to the MLA and this interpretive rule might be more like \$21.7 million.⁸ Within this further market segment, an undetermined percentage of these products actually offer interest rates greater than 36

⁷ See Experian, “State of the Automotive Finance Market: A Look at Loans and Leases in Q4 2016,” at 11, 19 (2016); Colonnade Advisors, “F&I Products Industry Market Commentary,” at 2 (2016), *available at* coladv.com/wp-content/uploads/FI-Product-Industry-Report-April-2016.pdf; F&I and Showroom, “Tracking F&I Performance,” <http://www.fi-magazine.com/article/story/2012/01/tracking-f-i-performance.aspx> (last visited Sept. 20, 2017). The Department’s research indicates that the available data regarding credit-related ancillary products in the auto lending marketplace are limited and primarily derived from informal surveys and reports.

⁸ Approximately 82 percent of Service members are enlisted; 91 percent do not have college degrees; 44 percent are under 25 years of age; and 67 percent of those under 25 own or lease at least one vehicle. The intersection of these portions creates a factor of approximately .22, which can be applied to the total market value of approximately \$93.8 million, resulting in a possible market segment of approximately \$21.7 million. This segment would then require further apportionment to reflect the share of the products therein that offer interest rates above the 36 percent cap. See 2015 Demographics Profile of the Military Community, Chapter 2, Department of Defense, *available at* <http://download.militaryonesource.mil/12038/MOS/Reports/2015-Demographics-Report.pdf> and Table 3202. Consumer units with reference person under age 25 by income before taxes: Average annual expenditures, Consumer Expenditure Survey, 2015-2016, Bureau of Labor Statistics, *available at* <https://www.bls.gov/cex/2016/CrossTabs/agebyinc/xunder25.PDF>.

percent and would actually be purchased by this group, which would represent the share of products that fall under the MLA requirement. Generally, in this and other possible scenarios across age groups and other demographic characteristics, the Department anticipates the universe of products that exceed 36 percent interest in this category is very small and possibly negligible, especially considering the time that has passed since the final rule was issued. This number is anticipated to be even more likely to be negligible when considering the number of covered borrowers who would choose to consume this product particularly in light of the existing MLA requirement.

2 U.S.C. Ch. 25, "Unfunded Mandates Reform Act"

Section 202 of the Unfunded Mandates Reform Act of 1995 (2 U.S.C. 1532) requires agencies to assess anticipated costs and benefits before issuing any rule whose mandates require spending in any 1 year of \$100 million in 1995 dollars, updated annually for inflation. In 2014, that threshold is approximately \$141 million. This rule will not mandate any requirements for State, local, or tribal governments, nor will it affect private sector costs.

Public Law 96-354, "Regulatory Flexibility Act" (5 U.S.C. Ch. 6)

The Department of Defense certifies that this rule is not subject to the Regulatory Flexibility Act (5 U.S.C. 601) because it would not, if promulgated, have a significant economic impact on a substantial number of small entities. Therefore, the Regulatory Flexibility Act, as amended, does not require us to prepare a regulatory flexibility analysis.

Public Law 96-511, "Paperwork Reduction Act" (44 U.S.C. Chapter 35)

This rule does not impose reporting and record keeping requirements under the Paperwork Reduction Act of 1995.

Executive Order 13132, "Federalism"

This rule was analyzed in accordance with the principles and criteria contained in Executive Order 13132 ("Federalism"). It has been determined that it does not have sufficient Federalism implications to warrant the preparation of a Federalism summary impact statement. This rule has no substantial effect on the States, or on the current Federal-State relationship, or on the current distribution of power and responsibilities among the various local officials. Nothing in this rule preempts any State law or regulation. Therefore, the Department did not consult with State and local officials because it was not necessary.

Dated: December 11, 2017.

Patricia L. Toppings,
OSD Federal Register Liaison Officer,
Department of Defense.

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