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The Department of Defense … What are They Thinking?

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2017 ended with a surprise to the auto finance industry-and not a good one! 2018 opened with chaos. All compliments of the Department of Defense's ("DOD") December 2017 pronouncement on what their Military Lending Act ("MLA") Rule covers and doesn't.

Both dealers and finance companies asked: "Are my auto finance transactions covered by the MLA?" "Then, how can GAP waivers be sold to servicemembers who want it?" and "What do I about past transaction that occurred after October 3, 2016?" "Are you sure this is what you meant?". As you know *(unless you've been living under a rock)*, the cause for all these questions is a December 11, 2017 DOD interpretive rule *clarifying what the DOD meant* in a MLA Rule it published in 2015.

Let's review. The MLA was enacted in 2007 and later amended by Congress in 2013. It provides protections to "covered borrowers," who are generally servicemembers and their dependents. Originally, the MLA's protections applied only to certain products-payday loans, title loans and refund anticipation loans. However, in 2013, Congress extended these protections to a much broader range of closed-end and open-end credit products. However, it included two exceptions to its general rule: one for purchase money personal property secured financing, and the second for purchase money motor vehicle secured financing.

In other words, Congress did not apply the requirements of the MLA to credit transactions where the servicemember *(the official term is "covered borrower")* obtains financing to buy a vehicle or personal property secured by such vehicle/personal property.

As with so many other Congressional statues, an agency was given authority to issue rules implementing the law. And for the MLA, it is the DOD. The DOD issued its rule in 2007, which it later revised in July 2015, in response to the 2013 Congressional amendment to the MLA. And, there is one last relevant fact-the 2013 amendment requires the DOD to consult with certain federal regulators, including the CFPB, regarding its rulemaking. The CFPB's influence can be felt in the current chaos.

The beginning of the uncertainty as to whether the MLA applies to motor vehicle and personal property purchase money financing began in August 2016, when the DOD issued its first interpretive rule in the form of 19 FAQs. The purpose was to explain how the DOD interprets its 2015 rule. In one of its FAQs, the DOD addressed the *personal property exception* and the extent to which the MLA applies when the covered borrower obtains a "cash out" as part of the financing. The FAQ explained, rather unartfully, that the exclusion applied only if the item being financed was personal property, and that any "cash out" took the transaction out of the exception, resulting in all provisions of the MLA applying. Because the motor vehicle financing exclusion is identical to the personal property exclusion, this startled the auto finance

community, causing them to question the application of the motor vehicle financing exception.

The DOD recognized the confusion and, in an effort to rectify it, issued a second interpretive rule on December 2017. The DOD also threw in a few more FAQs. In this second interpretive rule, the DOD recanted the FAQ that caused the confusion in 2016, and replaced it with another FAQ. This replacement FAQ "clarified" that the DOD interprets the personal property and motor vehicle exceptions to apply to the "object" being financed and costs related to the "object." This does not include "credit-related costs." Inclusion of "credit-related costs" disqualifies the transaction from the exception, and, the MLA applies. And, the DOD further "clarified" that this has always been its interpretation-meaning that it retroactively dates back to the October 3, 2016, the Rule's effective date.

So, now creditors are in an untenable position - every transaction involving a "covered borrower" after October 3, 2016 that included credit-related costs may violate the MLA. And note, there is no way to remediate.

Ain't that a pickle! Why no ability to remediate? Because a transaction that violates the MLA is void. Void is a specific legal term that means "never existed." It doesn't mean canceled or rescinded; rather, it means that it never was. And, on top of that, there are other penalties: criminal liability for a knowing violation, actual damages no less than $500, punitive damages, attorney's fees and equitable relief.

And that's just looking back! Looking forward, there is more fun?! There are other protections afforded "covered borrowers," including, but not limited to:

- The calculation of a military APR ("MAPR"), which MAPR cannot exceed 36% *(the MAPR is much like an "all in" APR-which must include the cost of ancillary products)*;
- Providing certain oral disclosures regarding the covered borrower's rights under the MLA;
- Providing certain written disclosures regarding the covered borrower's rights under the MLA;
- Prohibition against mandatory arbitration provisions;
- Prohibition against waivers of a covered borrower's right to legal recourse under any state or federal laws, such as the Servicemembers Civil Relief Act; and
- Prohibition against using a title as security for the obligation.

Note that industry trade associations are not sitting on their hands. They are actively advocating for their members, explaining to the DOD and Congress that this "interpretive rule" has serious consequences, mostly negative for servicemembers and the industry. Access to credit will be affected, and the real benefit of GAP coverage will be lost to those servicemembers who seek this protection *(which is a way bigger population than the DOD thought)*.

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