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Re: Issues to address in Military Lending Act Examination Procedures

The Department of Defense on August 26, 2016 published an interpretive rule to help clarify various provisions in the 2015 amendments to the Military Lending Act Rule (MLA Rule) for which compliance is mandatory on October 3, 2016. Critical to the compliance regime will be the examination procedures used by the banking agencies to review financial institutions for compliance. The banking agencies' examination procedures offer the opportunity to clarify a number of important issues that will help to facilitate compliance and also ensure that military personnel and their spouses and dependents continue to have access to important bank credit products. In drafting the examination procedures, the American Bankers Association asks that the banking agencies consider the following suggestions.

- 1. Distinguish between “phony” purchase money loans designed to evade the requirements and legitimate purchase loans with related services and products financed by the loan so that covered borrowers may finance related services and items such as car warranties, taxes, and delivery fees.**

The MLA Rule provides that a secured loan is exempt if it is expressly intended to finance the purchase of personal property and is secured by the personal property being financed. The interpretive rule (Q&A 2) describes how a lender may not circumvent the MLA Rule by attempting to characterize a cash loan as an exempt secured transaction, for example, by providing cash out financing in connection with a secured loan.

Examiners should distinguish attempts to circumvent the MLA Rule through phony “secured” transactions from legitimate secured loans that include financing for incidental expenses related to the underlying purchase, such as shipping and delivery charges, taxes, warranties, and other services directly connected to the transaction. Therefore, the latter loans would qualify for the exemption so long as they meet the regulatory requirements for exclusion (i.e., are expressly intended to finance the purchase of the personal property and are secured by the personal property being purchased).

In addition, this approach should also apply to “vehicle” purchase loans.

2. Allow lenders to rely on the customer’s statement that the loan is being made to purchase a vehicle or personal property.

The MLA Rule exempts loans that are “expressly intended to finance the purchase” of a vehicle or personal property when the credit is secured by the vehicle or personal property being purchased. Lenders will often advance loans to a customer who intends to use the loan to purchase a vehicle from a private seller (e.g., purchase a used car directly from the owner) and subsequently secure the loan with the purchased vehicle. The examination procedures should provide that the purchase money loan exemption applies in these situations. Otherwise, loans to make private purchases may not be available to covered borrowers.

3. Allow creditors to enjoy the safe harbor for determining military status if they make a determination of military status any time between 30 days prior to application and the time the account is established.

The MLA Rule provides that borrowers are covered if they are associated with the military *at the time the account is established* but also provides that the safe harbor for determining military status applies if inquiries are made *at the time a person applies for a loan or 30 days prior*. The interpretive rule (Q&A 10) appears to resolve the inconsistency of the MLA Rule with the statement, “Creditors must determine a consumer’s covered borrower status at or before the time of the transaction or at the time an account is established...” The examination procedures should be consistent with the interpretive rule and expressly recognize that banks are entitled to the safe harbor if the inquiry about military status is made at any time up to the time of account opening.

4. Allow creditors to enjoy the safe harbor for determining military status if they make an inquiry after the account is established for purposes of ascertaining whether the customer continues to be entitled to the rule’s protections.

The interpretive rule clarifies that lenders are permitted to screen credit portfolios periodically to discover changes to a covered borrower’s status.¹ Accordingly, they should be entitled to the safe harbor when they make an inquiry at this later time.

5. Allow covered borrowers to obtain loans secured by a bank account.

The collective answers to questions 16, 17, and 18 of the interpretive rule indicate that creditors may make loans secured by a bank account to covered borrowers, regardless of when the security interest is. It should be clear in the examination procedures that banks may make loans to covered borrowers regardless of when the security interest in the bank account is taken.

All three answers to questions 16, 17, and 18 of the interpretive rule focus on the meaning of §232.8(e), which prohibits using “a check or other method of access to a deposit...account”

¹ The definition of covered borrower excludes people who were covered borrowers at the time the account is opened but are no longer covered. The MLA Rule recognizes that the protections do not apply once the borrower is no longer a covered borrower.

of the covered borrower. The answers to each of these three questions reiterate that this section prohibits using “the borrower’s account information to create a remotely created check... in order to collect payment...” or using a “post-dated check provided at or around the time credit is extended that deprives the borrower of control over payment decisions, as is common in certain payday lending transactions.” The reiteration, without conditions or exceptions, suggests that the limit of the prohibition is the use of account information to create a debit device and that the provision should not be read as to imply a prohibition on a collateral interest in the underlying account.

In addition, the answer to question 17 states that this section “does not prohibit covered borrowers from granting a security interest to a creditor in the covered borrowers’ checking, savings, or other financial account, provided that it is not otherwise prohibited by applicable law and the creditor complies with the MLA regulation including the limitation on the MAPR to 36 percent.” There is no reference to any limitations on the timing of the security interest as would be expected – and important to clarify -- if there were any such limitations, especially as this was one of the highlighted issues ABA raised with the Department of Defense before issuance of the interpretive rule.

Finally, the answer to question 18 addresses creditors’ right to exercise a “statutory right” to take a security interest in a bank account, but then also states “[T]he 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)” (i.e., to prohibit the use of remotely created checks and post-dated checks). (Emphasis added.) It then goes on to clarify that creditors may exercise a statutory right to take a security interest in funds deposited in an account *at any time*, provided the creditor complies with other laws and the MLA Rule, including the limitation on the military annual percentage rate 36 percent.

While this question references a statutory security interest, it would be expected that if the timing requirements were different for contractual security interests, the interpretive rule would have made it clear. Yet, the answer does not refer to any such limitations for taking a contractual security interest or suggest that it is permitted only after the loan is made. Rather, the answer suggests that the “may” of §232.8(e), indicates that the provision is permissive and not restricted. Moreover, there is no reason for a statutory security interest to be treated differently from a contractual security interest, and if there were, it would be expected that the interpretive rule would highlight and explain such an important distinction.

Loans secured by a bank account are helpful for covered borrowers wishing to build or repair credit history. The examination procedures should make clear that military personnel and their spouses and dependents are eligible for such loans.

Many thanks for your consideration of these important issues.

Cc. Paul Kantwill