February 6, 2019

Via E-Mail

William S. Castle, Esq.
Principal Deputy General Counsel
Office of the General Counsel
U.S. Department of Defense
1600 Defense Pentagon, Rm 3E788
Washington, DC 20301-1600

Dear Mr. Castle:

I am writing to follow up on our October 12, 2018 letter to you (First Attachment), which explained how the action sought in petitions filed by the National Automobile Dealers Association (NADA), the Defense Credit Union Council (DCUC), and five other financial services trade associations with the Department of Defense (DOD) more than one year ago – seeking DOD's immediate withdrawal of Question and Answer 2 from DOD's Interpretive Rule pertaining to the Amended Military Lending Act Regulation (Q&A 2)[1] – is in the best interest of the Warfighter.

When we met with you and members of your staff last September, you indicated that, in evaluating whether to grant the petitions referenced above, the most important consideration would be the ultimate impact of Q&A 2 on the Warfighter. In our October 2018 letter, we directly addressed this consideration, explaining how DOD's issuance of Q&A 2 exposes service members to significant and unexpected liability that occurs when their vehicles are declared a total loss by effectively eliminating protection against such loss that is provided by optional GAP Waiver.[2] Since the submission of our October 2018 letter, the risks that we identified have, unfortunately, matured into quantifiable injury to service members. Accordingly, we are submitting this letter to supplement our earlier analysis with market data indicating that – by conservative estimates – **DOD's action has exposed approximately 5,000 Warfighters who purchased and financed vehicles in 2018 to approximately $15 million in liability from total loss occurrences.**

In light of this data, which we explain below, we renew our request that DOD immediately withdraw Q&A 2 to restore to service members the opportunity to protect themselves from incurring significant, unexpected, and unnecessary liability that threatens their military readiness.

[1] 82 Fed. Reg. 58,739 – 58,742 (Dec. 14, 2017).
[2] Our letter also explained that DOD's adoption of Q&A 2 was procedurally deficient and impermissibly narrowed Congress' motor vehicle financing exclusion to the Military Lending Act (MLA).

Data Analysis

The data to which we refer was developed by a finance source that engages in indirect vehicle financing transactions.[3]

Prior to DOD's issuance of Q&A 2, this finance source took assignment of retail installment sale contracts (RISCs) that motor vehicle dealers entered into with active duty service members which included optional GAP Waiver protection.[4] However, after – and as a result of – DOD's issuance of Q&A 2, this finance source (similar to numerous finance sources around the country) discontinued purchasing such RISCs.[5]

In order to measure the effect of Q&A 2 on the Warfighter, the finance source conducted the following analysis:

(i) Finance Source Data. The finance source analyzed its RISCs with active duty service members whose vehicles were declared a total loss by comparing the period before Q&A 2 was issued (in which it took assignment of RISCs involving GAP Waiver) and the period after Q&A 2 was issued (in which it discontinued taking assignment of such RISCs)(Second Attachment); and

(ii) Marketwide Impact. The finance source analyzed the marketwide impact Q&A 2 is having on active duty service members based on its informed understanding and assessment of the marketplace (Third Attachment).

Finance Source Data

The finance source provides its own data in the Second Attachment and bifurcates it into the period before Q&A 2 was issued (top half of the document) and the period after Q&A 2 was issued (bottom half of the document). It reveals the following:

- For the 3-year period prior to the issuance of Q&A 2, the finance source took assignment of 1,554 RISCs with active duty service members where the vehicle was ultimately declared a total loss.

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[3] An indirect vehicle financing transaction is a transaction in which a motor vehicle dealer enters into a retail installment sale contract with a consumer and then assigns the contract to a finance source.

[4] GAP Waiver is part of a finance agreement between a motor vehicle creditor and motor vehicle purchaser in which the creditor agrees to waive its right to collect certain amounts the purchaser has agreed to pay the creditor in the event of a total physical loss or unrecovered theft (total loss) of the financed vehicle.

[5] Because 32 C.F.R. section 232.8(f) prohibits motor vehicle dealers who enter into RISCs with covered borrowers from taking a security interest in the motor vehicle being financed and this restriction would effectively flow to assignees of the RISC (whether depository institutions or non-depository institutions), finance sources around the country have informed dealers that they are unwilling to take assignment of such RISCs.

- In 1,258 of these 1,554 RISCs (or 81%), the service members opted to purchase GAP Waiver and subsequently received GAP Waiver benefits as a result of the loss. In fact, among those 1,258 RISCs, the average GAP Waiver benefit each service member received exceeded $3,000 and the collective GAP benefits this group received exceeded $3.8 Million.

- Conversely, during the same 3-year period, in 296 of the 1,554 RISCs (or 19%), the service members decided not to purchase GAP Waiver[6] and subsequently owed on their RISCs nearly $2,400/service member and $700,000 collectively.

- Following the issuance of Q&A 2, the finance source took assignment of 117 RISCs with active duty service members who were not offered GAP Waiver as a result of Q&A 2, had their vehicles declared a total loss, and subsequently owed on their RISCs over $2,800/service member and $329,000 collectively.

- The data also reveals that the number of service members who are experiencing total losses without GAP Waiver protection is sharply increasing over time. The finance source possessed 82 such RISCs through the end of November 2018. However, one month later (through the end of December 2018), that number had climbed to 117 (a 43% increase). The data for subsequent months will reflect further increases as the number of service members who incur total losses without GAP Waiver rises.

Marketwide Impact

- The foregoing data is derived from only one of several hundred finance sources that take assignment of RISCs with active duty service members. Accordingly, in the Third Attachment, the finance source projects the collective (marketwide) impact that Q&A 2 has had on all service members in 2018.

- Based on conservative assumptions, the finance source projects that approximately 5,000 service members who incurred total losses in 2018 will owe approximately $15 million after the receipt of insurance proceeds.

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[6] This data refutes allegations that optional GAP Waiver is presented to consumers as a mandatory product.

- This figure is derived as follows:

1,300,000	Total 2018 Active Duty Military Population (Fourth Attachment)
÷ 6.5	Average frequency (number of years) of automobile purchase
× 5%	Average frequency of total loss
× $3,000	Estimated average balance due on RISC after total loss[7]
× 50%	Average percentage of RISCs that include optional GAP Waiver
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$15,000,000	

- As noted above, these figures are based on conservative estimates and therefore could significantly understate the adverse impact that the loss of GAP Waiver protection is having on active duty service members.[8]

- Nevertheless, even using these conservative estimates, the adverse impact Q&A 2 had on service members' readiness in 2018 is dramatic and only getting worse.

<u>Conclusion</u>

The foregoing demonstrates that DOD's ill-advised adoption of Q&A 2 has exposed the Warfighter to millions of dollars in unexpected and avoidable liability. Further, with each day, DOD's delay in withdrawing Q&A 2 is resulting in additional service members incurring such liability exposure as they continue to purchase and finance motor vehicles without GAP Waiver protection. Accordingly, the best interests of the Warfighter clearly would be served by immediately withdrawing Q&A 2 and only acting on this matter after DOD has had the opportunity to carefully consider how its action will affect service members and further the purpose of the Military Lending Act.

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[7] As noted in the Second Attachment to our October 12, 2018 letter, service members who incur a total loss often owe – and receive GAP benefits for – amounts that significantly exceed $3,000. In addition, with the continual rise in new vehicle prices (11% since 2013) and used vehicle prices (13% since 2013)(*NADA Average Dealership Financial Profile*), the gap between insurance payouts for total losses and the amount due on vehicle finance contracts also can be expected to rise.

[8] For example, while covered borrowers under the MLA include the active duty military population of approximately 1.3 Million, they also include, in addition to dependent children, nearly 700,000 spouses of military members. While not all 1.3 Million active duty military members will purchase and finance motor vehicles, this figure accounts for none of the nearly 700,000 spouses of active duty service members or dependent children who purchase and finance motor vehicles and are covered borrowers. In addition, while the finance source estimates the average purchase frequency of a vehicle to be 4.5 to 6.5 years, it uses the 6.5 figure for its calculation. Similarly, while many believe the total loss rate for active duty service members to be higher than the total loss rate for the population at large, the finance source's calculation relies on a 5% industry (both military and civilian) average. Finally, while the finance source's GAP penetration is approximately 75%, the calculation assumes a much lower average industry GAP penetration of 50%. Each of these assumptions significantly reduces the estimated impact calculation.

Thank you for your consideration of this information. Please let me know if there is anything further we can provide you.

Sincerely,

/s/

Paul D. Metrey
Vice President, Regulatory Affairs

Attachments

Cc: The Honorable James Michael Mulvaney
The Honorable Patrick M. Shanahan
The Honorable James N. Stewart
The Honorable Paul C. Ney, Jr.

Attachment 1

October 12, 2018

Via E-Mail

William S. Castle, Esq.
Principal Deputy General Counsel
Office of the General Counsel
U.S. Department of Defense
1600 Defense Pentagon, Rm 3E788
Washington, DC 20301-1600

Dear Mr. Castle:

Thank you again for recently meeting with the National Automobile Dealers Association (NADA)[1] and the Defense Credit Union Council (DCUC) to discuss the petitions that have been sent to the Department of Defense (DOD) by NADA, DCUC, and five other financial services trade associations requesting the immediate withdrawal of Question and Answer 2 from DOD's Interpretive Rule pertaining to the Amended Military Lending Act Regulation (Q&A 2).[2] During our meeting, you indicated that the position of the DOD Office of General Counsel (OGC) on the petitions would be determined by "what is in the best interest of the Warfighter" and, to that end, you encouraged us to send to you a letter demonstrating how our petition meets that standard. This letter provides that information and presents it in three parts: (i) a discussion of the process DOD adopted in issuing Q&A 2, (ii) an analysis of whether Q&A 2 is consistent with the Military Lending Act (MLA), and (iii) an assessment of the impact that Q&A 2 is having on the Warfighter.[3]

<u>The Process</u>

While examining the effects of any action on the Warfighter is a paramount consideration, it does not exist in a vacuum and can only be arrived at in accordance with statutorily-mandated procedures. The Administrative Procedures Act (APA) establishes prerequisites that must be

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[1] NADA represents over 16,000 franchised dealers in all 50 states who (i) sell new and used cars and trucks; (ii) extend vehicle financing and leases to consumers that routinely are assigned to third-party finance sources; and (iii) engage in service, repair, and parts sales. Our members collectively employ over 1 million people nationwide. Most of our members are small businesses as defined by the Small Business Administration.
[2] 82 Fed. Reg. 58,739 – 58,742 (Dec. 14, 2017).
[3] This letter is not intended to supplant – and should not be viewed as constituting – the formal and more comprehensive submission of information that NADA would offer in response to a future request for comment, advanced notice of proposed rulemaking, and/or notice of proposed rulemaking from DOD on the scope of the motor vehicle financing exclusion to the MLA.

met when establishing a new substantive standard in the marketplace[4] and, even if these requirements did not exist, the public policy rationale for engaging in an informed process to guide agency decisions *before* they are made is compelling. When this occurs, the objectives of the agency action are more likely to be realized and the problems caused by unintended consequences flowing from such action are more likely to be diminished.

The benefits of an informed process are self-evident and particularly applicable to this issue. To recap what occurred in this instance, DOD's issuance of Q&A 2 –

(i) created a new substantive standard in the marketplace (i.e., that extending financing to covered borrowers for credit-related products such as GAP protection that are financed with a motor vehicle being financed is not covered by the congressionally-created motor vehicle financing exclusion to the MLA and therefore subjects the transaction to the MLA);
(ii) occurred without providing the public notice or an opportunity to comment on the new standard;
(iii) occurred without any analysis of its impact on covered borrowers (i.e., the Warfighter) or the creditors which serve them;
(iv) took effect immediately, and
(v) purported to apply retroactively to over 14 months of transactions *that had already occurred* (i.e., those occurring since the Amended MLA Rule took effect on October 3, 2016).

Regrettably, we are just now, nearly 10 months after DOD issued Q&A 2 and more than two years after the rule it interprets took effect, beginning to engage in a dialogue on how Q&A 2 affects the Warfighter. This is occurring –

(i) with DOD officials expressing a willingness to examine important aspects of this issue (e.g., what is the availability, cost, and benefits of GAP protection and how is it marketed and presented to covered borrowers in the marketplace); and
(ii) after natural disasters such as Hurricane Florence that have materially affected covered borrowers have occurred.

Clearly, understanding such critically important issues is essential to giving effect to a rule of this magnitude and should occur well *before* such a rule is developed and applied to the marketplace. Regrettably, this did not occur here and, as explained below, harm to service members and chaos in the marketplace has ensued. While these adverse consequences cannot be undone, their continuance can be mitigated by immediately withdrawing Q&A 2 as sought in the petitions. Should DOD desire to issue an interpretation in this matter, it should only do so after it has benefitted from the information that would be presented to it following public notice of, and comment on, the proposed rule, including the extent to which the rule is consistent with and

[4] See *New Hampshire Hospital Association v. Azar*, 887 F.3d 62 (1st Cir. 2018)(holding that Frequently Asked Questions posted by the Secretary of Health and Human Services on the Medicaid website was a legislative rule, not an interpretive rule exempt from APA's notice and comment requirements).

furthers the purpose of the statute. As part of the rulemaking process, DOD could invite comment on specific questions (such as those that were presented to us during our meeting) that would help inform it on the matter.

The Statute

In addition to the need to ensure that the process for creating a new substantive standard in the marketplace is fully informed, DOD also must ensure that its creation of such a standard is consistent with the authority granted to it by Congress in the authorizing statute. The MLA grants DOD authority to prescribe regulations to implement the statute, including authority to establish a definition of "consumer credit," provided it is "consistent with the provisions of this section,"[5] including the MLA's exclusion from this definition of "a loan procured in the course of purchasing a car or other personal property, when that loan is offered for the express purpose of financing and is secured by the car or personal property procured."[6] Thus, while DOD has broad authority to carry out the terms of the MLA, it may not disregard the will of Congress by narrowing the express exclusion Congress created for vehicle finance agreements that are secured by the motor vehicle being financed.

As mentioned during our meeting, when consumers enter into vehicle finance agreements with motor vehicle dealers, they routinely grant the dealer-creditor a security interest in not just the motor vehicle being financed, but other related items such as insurance, maintenance, service, and other contracts that are included in the finance agreement. Importantly, *all of these items* are part of the "loan [that] is offered for the express purpose of financing and is secured by the car… procured;" therefore, Congress has excluded them from the definition of "consumer credit," and DOD may not act to the contrary. The distinction DOD drew in Q&A 2 between (i) product-related items, such as optional leather seats, extended service contracts, and negative trade equity, which it states fall within Congress' motor vehicle financing exclusion, and (ii) credit-related items, such as GAP protection and credit insurance, which it states fall outside of Congress' exclusion, is both arbitrary and an impermissible narrowing of this exclusion.

The Warfighter

The most regrettable consequence of the process flaws that accompanied DOD's release of Q&A 2 and its inconsistency with the will of Congress is the adverse effect it is having – and will continue to have – on the Warfighter.

As explained in the Supplementary Information to the Amended MLA Rule, it is essential that service members "maintain personal readiness standards, including paying their debts and maintaining their ability to attend to the financial needs of their families."[7] The extent to which any particular financial product or service contributes to, or detracts from, this imperative requires a careful analysis of its characteristics and availability in the marketplace. As it relates

[5] 10 U.S.C. § 987(h)(2)(D).
[6] 10 U.S.C. § 987(i)(6).
[7] 80 Fed. Reg. 43,560, 43,564 (Jul. 22, 2015).

to optional Guaranteed Asset Protection (GAP) Waiver offered, sold, and financed by motor vehicle dealers and assigned to banks, finance companies, and credit unions, service members and other consumers benefit considerably from the protection it provides.

GAP Waiver is part of a finance agreement between a motor vehicle creditor and motor vehicle purchaser in which the creditor agrees to waive its right to collect amounts the purchaser has agreed to pay the creditor in the event of a total physical damage loss or unrecovered theft (total loss) of the financed vehicle. While the purchaser can make a claim with its automobile insurance carrier in the event the vehicle is declared a total loss, the payout from the insurer usually is limited to the actual cash value of the vehicle less any applicable deductible. Because automobiles typically depreciate rapidly in the early stages of ownership, the "gap" between the insurance payout and the amount owed on the finance agreement can be considerable and is heightened when the purchaser (i) has a high deductible on its automobile insurance policy, and/or (ii) has opted to include in the finance agreement the amount owed (i.e., the lien balance) on a trade-in vehicle (also known as negative equity). GAP Waiver products typically eliminate this gap by waiving the creditor's right to collect these amounts in the event of a total loss of the purchaser's vehicle. In this way, the purchaser is made whole and, in the case of a service member, not confronted with significant and unexpected debt that can adversely affect his or her military readiness.

Notwithstanding DOD's assumption to the contrary, GAP Waiver cannot simply be lifted out of the transaction and offered as a separate product.[8] A GAP Waiver agreement, as its name suggests, is an agreement in which the creditor, for consideration from the purchaser, agrees to waive its right to collect amounts owed to it by the purchaser under the finance agreement if a total loss event occurs. The ability to waive a right to enforce an obligation only exists if an underlying obligation exits. Stated differently, a creditor cannot waive its right to enforce an obligation if that obligation hasn't been undertaken in the first instance. For this reason, GAP Waiver cannot be offered by a dealer outside of the finance agreement, nor can a third party that is not a party to the finance agreement agree to waive a right to enforce a payment obligation that has not been made to it.

Entirely separate from GAP Waiver is GAP Insurance. As explained by the Consumer Credit Industry Association and Guaranteed Asset Protection Alliance in the first Attachment, GAP Insurance typically is sold as an endorsement to an automobile insurance policy by an automobile insurance carrier and its availability in the marketplace is far more limited than GAP Waiver. In addition, many of the GAP Insurance endorsements that do exist provide coverage that is more limited in scope than the coverage provided by GAP Waiver.

The assumption that dealers can manage this issue by simply complying with the MLA's duties and restrictions when GAP Waiver is sold to a covered borrower is similarly flawed. DOD's regulation implementing the MLA prohibits non-depository institutions (which includes motor

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[8] DOD apparently assumes this is possible in its statement: "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*." (Emphasis added.) 82 Fed. Reg. at 58,741.

vehicle dealers) from taking a security interest in a vehicle being financed with a covered borrower.[9] The inability of a dealer acting as the original creditor or a bank, credit union, or finance company acting as an assignee creditor (i.e., a creditor that takes assignment of a finance agreement entered into by a dealer and a purchaser) to protect itself from default by taking a security interest in a financed vehicle makes dealer-assisted financing under the MLA economically unviable. There is no better evidence of this reality than the fact that, shortly after DOD issued Q&A 2, assignee creditors all over the country communicated to dealers that they would no longer take assignment of finance agreements between dealers and covered borrowers that include GAP Waiver. Because assignee creditors will not provide financing for these contracts and dealers generally lack the capital to do so themselves (and even if they possessed the capital, they can no more engage in unsecured financing than assignee creditors), dealers throughout the country have discontinued offering GAP Waiver to active duty service members and their dependents.[10]

These circumstances, which are the direct result of DOD's issuance of Q&A 2, have unfortunately left the Warfighter in a perilous position. Prior to December 14, 2017, GAP Waiver (i) was routinely offered to service members when they financed a vehicle purchase through the dealer, (ii) provided the many service members who purchased GAP Waiver with substantial protection against the financial loss created by the total loss of their vehicle, and (iii) allowed service members to budget for this protection.

In contrast, in the aftermath of this issuance, many service members (i) are not learning about this protection through a product offering by the dealer from which they purchased and financed their vehicle, and (ii) are not obtaining similar protection from a GAP Insurance endorsement (because such an endorsement from their insurance carrier does not exist, they are unaware of it, or it does not provide the same level of protection).

Consequently, events that cause total vehicle losses such as accidents, theft, floods, wind storms, hail, and other natural disasters have left – and continue to leave – service members who recently financed vehicle purchases exposed to considerable financial hardship. Indeed, Hurricane Florence is believed to have damaged or destroyed at least 20,000 vehicles.[11] Given the strong military presence in the path of the storm, it is likely that a large number of service members who (i) purchased and financed vehicles from automobile dealers, (ii) were not offered and therefore did not secure GAP protection as a result of DOD's issuance of Q&A 2, and (iii) sustained a total loss of their vehicle, have incurred an unexpected financial obligation. This financial obligation can be considerable, as is evident from a small sample of GAP Waiver

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[9] 32 C.F.R. § 232.8(f).

[10] Thus, the answer to one of the questions that was presented during the meeting – that is, whether dealers' concerns with Q&A 2 are driven by a desire to avoid having to comply with the 36% Military Annual Percentage Rate (MAPR) cap – is, simply put, no. Application of the 36% MAPR cap is not the challenge confronting dealers and assignee creditors as a result of Q&A 2. While this cap would present computational challenges (that far exceed concerns about exceeding the MAPR cap) and such concerns are particularly salient for our small business members, dealers and assignee creditors do not even reach this issue due to the security interest non-starter.

[11] See https://www.jsonline.com/story/money/business/2018/09/19/thousands-cars-damaged-florence-floods/1360475002/.

payments that were made to service members who obtained GAP Waiver from North Carolina automobile dealers *before* DOD's issuance of the interpretive rule (see the second Attachment).[12] Regrettably, this raises the inescapable concern that Q&A 2 – no matter how well intended – is serving to undermine, not promote, "military personnel readiness standards" and, as a result, is operating to frustrate – not further – the purpose of the MLA. This clearly is not in the best interest of the Warfighter.

Notwithstanding the many compelling arguments for ensuring that GAP Waiver is available to service members, your office expressed concerns during our meeting about reports it has received that GAP Waiver is being presented to service members as a mandatory product. As we explained in response, while it is difficult to prove the negative, consumers who wish to purchase GAP Waiver must review and sign a clear and prominent disclosure on the front of the vehicle financing agreement stating both that GAP Waiver is optional and the amount they will pay for it.[13] Were a creditor to contradict this written disclosure in an oral statement, it would constitute and unfair or deceptive act or practice (UDAP) for which remedies exist under federal and state law. Further, an additional layer of protection exists as many GAP Waiver contracts provide (i) a free look back period (typically 30 days) in which a consumer can cancel GAP Waiver and receive a full refund of the amount paid for it, and (ii) even beyond this period, the ability to cancel GAP Waiver and receive the unearned portion of the premium.

These important rights and protections aside, DOD's decision in this matter should be supported by credible evidence that GAP Waiver abuses involving service members are *prevalent* in the marketplace and not by anecdotal, unsubstantiated reports of bad behavior.[14] To do otherwise

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[12] Of course, flood damage can be worse than the considerable damage caused by Hurricane Florence. 1n 2017, Hurricanes Harvey and Irma damaged up to 1,000,000 vehicles and also affected areas with a military presence. See http://fortune.com/2017/09/20/hurricane-irma-harvey-damaged-cars/. However, these storms occurred before the issuance of the DOD rule and its adverse effect on the availability of GAP Waiver to service members. In addition, as of the date of this letter, Hurricane Michael, which made landfall as a strong Category 4 Hurricane and retained its hurricane strength as it entered Georgia and Alabama, is similarly affecting areas with a heavy concentration of service members.

[13] For example, the sample vehicle finance agreement from Alabama that we displayed during the meeting states in a separate box: "**OPTIONAL GAP CONTRACT.** A gap contract (debt cancellation contract) is not required to obtain credit and will not be provided unless you sign below and agree to pay the extra charge. If you choose to buy a gap contract, the charge is shown in item 4C of the Itemization of Amount Financed [which reads" Optional Gap Contract $____]. See your gap contract for details on the terms and conditions it provides. It is part of this contract." The box also includes the name and term of the GAP Contract and a signature line for the Buyer under the words: "I want to buy a gap contract."

[14] Other federal agencies have recognized the importance of relying on data – and not anecdotes – to establish whether alleged harmful practices are prevalent in the marketplace and may warrant the imposition of new duties and obligations on regulated entities. For example, the following statements were made by the Federal Trade Commission or Commission officials during an extensive set of motor vehicle roundtables the Commission conducted in 2011 for this purpose: (i) the Commission's Statement under "Roundtable Goals and Topics for Comment" in the Notice entitled "Public Roundtables: Protecting Consumers in the Sale and Leasing of Motor Vehicles," 76 Fed. Reg. 14,014 – 14,017 (Mar. 15, 2011): "Of particular interest is data and empirical evidence supporting comments provided in response to this request;" (ii) the comments of FTC Division of Financial Practices Associate Director Joel Winston at Panel 1 of the Detroit Roundtable: "And just to emphasize, what we're going to be looking for throughout this session today and future sessions is as much empirical evidence as possible.

will continue to deprive service members of the opportunity to protect themselves against very real, costly, and current total loss events which, in turn, will further undermine their military readiness.

Conclusion

Based on the flawed process DOD used to issue Q&A 2, its inconsistency with the statute it interprets, and its adverse effect on the Warfighter, we ask that OGC facilitate the immediate withdrawal of Q&A 2 as requested by NADA and the American Financial Services Association in its joint petition to DOD dated January 18, 2018.

Thank you for your assistance in this matter. Please let me know if we can provide you with any additional information.

Sincerely,

/s/

Paul D. Metrey
Vice President, Regulatory Affairs

Attachments

Cc: Paul S. Koffsky, Esq.
David Gruber, Esq.

We've all heard stories and anecdotes and individual cases where consumers were mistreated in one way or another. One of the real goals of this process is to find out how prevalent those practices are. So if there are any studies, any sort of empirical data – that's something we'd be interested in seeing;" (iii) the comments of FTC Division of Financial Practices Attorney Carole Reynolds at Panel 4 of the Detroit Roundtable: "Does anyone have data on these practices occurring?;" (iv) the comments of FTC East Central Region Director John Miller Steiger at the conclusion of the Detroit Roundtable: "… And in order to get good useful answers, we need data. And I know you've heard that from us as a constant refrain, but we really do…;" (v) the comments of FTC Division of Financial Practices Assistant Director Malini Mithal at Panel 1 of the San Antonio Roundtable: "To the extent we have any information about widespread practices, that would be helpful from the panelists" and "Has there been any kind of analysis of trends and complaints from military consumers or any kind of… statistics or any widespread practices that we have any information about?;" (vi) the comments of FTC Bureau of Consumer Protection Deputy Director Chuck Harwood at the beginning of the DC Roundtable: "We are especially interested in data and empirical information;" (vii) the comments of FTC Division of Financial Practices Attorney Robin Thurston at Panel 4 of the DC Roundtable: "And, again, if you have data or other indicators of how frequently these practices occur, that would be great;" and (viii) the comments of FTC Division of Financial Practices Acting Associate Director Reilly Dolan at the conclusion of the DC Roundtable: "…We are looking at whatever data we can get. And I will continue to say, please give us hard facts and data. That's more persuasive than anecdotes." Information on the Motor Vehicle Roundtables is available at (i) Detroit Roundtable: www.ftc.gov/news-events/press-releases/2011/03/ftc-roundtables-will-address-consumer-issues-motor-vehicle; (ii) San Antonio Roundtable: www.ftc.gov/news-events/press-releases/2011/07/second-ftc-roundtable-discuss-motor-vehicle-sales-and-financing; and (iii) Washington, D.C. Roundtable: www.ftc.gov/news-events/press-releases/2011/10/third-ftc-roundtable-cover-motor-vehicle-leasing-issues-review.

CCIA
Consumer Credit Industry Association

gapa
GUARANTEED ASSET PROTECTION ALLIANCE

GAP Waivers Offer Significant, Accessible Value to Service Members

GAP Waiver is an optional voluntary protection product offered to households borrowing funds to purchase a vehicle; it covers all or part of the unpaid balance the borrower owes when a vehicle is totaled as a result of a crash, theft, natural disaster, or otherwise and the amount owed on the auto financing exceeds the insurance proceeds paid for the total loss. (This could occur, for example, because the vehicle value decreases faster than the loan balance and/or because the loan included a balance rolled over from a prior loan.)

GAP Waivers Support DoD Expectations of Service Members

GAP waivers provide meaningful, significant value to military households by extinguishing debt during a difficult time (remember, their vehicle has been totaled or stolen). By helping with financial stability for service members, GAP waivers support the DoD's personnel readiness expectations, which includes "…paying their debts and maintaining their ability to attend to the financial needs of their families."[1]

To illustrate with a real-life example:[2]

"J.D." – Service member from Kentucky	
Loan payoff on date of loss	$26,467.67
Minus: Primary auto insurance payment	($13,377.51)
Minus: Refunds from other products	($1,762.56)
Equals: GAP waiver benefit	**$11,327.60**

What the servicemember would still owe without GAP Waiver

GAP Waivers Offer Significant Additional Benefits When Compared with GAP Insurance

GAP Waivers offer more benefits to service members than those members receive under GAP insurance policies offered by auto insurance carriers. With GAP Waivers, service members also get coverage for:

- A balance rolled in from a prior loan (i.e., "rolled over negative equity"); GAP insurance generally does not pay for negative equity;
- Their insurance policy deductible – often worth $500 to $1,000[3] at claim time;
- Total losses caused by someone else where that person's auto liability insurance covers the physical damage loss up to the vehicle value; and
- A car or truck that is up to 20 years old; GAP insurance generally only extends to vehicles 3 years old or less.

By way of illustration:

	Waiver	Insurance
Loan payoff on date of loss	$23,000	$23,000
(Portion from roll over = $3,000)		
Minus the primary carrier settlement	($15,000)	($15,000)
(Deductible = $1,000)		
Loan balance after carrier settlement	$8,000	$8,000
GAP Benefit	**$8,000**	$4,000

GAP Waiver covers the $1,000 deductible and $3,000 roll over balance; GAP insurance does not

[1] U.S. Dep't of Def., Instruction 1344.09, Indebtedness of Military Personnel (2008), as noted in "Report: Enhancement of Protections on Consumer Credit for Members of the Armed Forces and Their Dependents," U.S. Dep't of Def., April 2014

[2] From CCIA member company claim records.

[3] Allowed in most states.

GAP Waivers Are Much More Accessible to Service Members Than GAP Insurance

- Three of the top 10 auto insurance carriers do not offer GAP insurance at all. Two of the 7 that offer it only make it available if the car loan is from the insurance carriers' lending affiliate.[4]
- GAP insurance is typically unavailable in the higher risk auto insurance market, which comprises roughly 30-40% of the total auto insurance market.[5]
- This suggests GAP insurance is entirely unavailable for at least half the market, if not more.
- In contrast, GAP Waiver is available to all – from auto dealers and lenders nationwide.

Claims Regarding the Cost of GAP Insurance Are Misleading

Some advocates have asserted that GAP insurance can often cost as little as $20 to $30 a year. However, this figure is highly misleading, especially with regard to servicemembers and their families. First, as noted, it is only available from a limited number of car insurance carriers so it is simply unavailable to many. Second, that estimated price is limited to the least risky drivers, and many service members tend to be in the higher risk cohorts due to age.[6] Thus, the $20 and $30 figure is unrealistic for servicemembers and their families.

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[4] Per review of public online information; top 10 insurers based on 2017 Direct Written Premium; https://www.nerdwallet.com/blog/insurance/car-insurance-basics/largest-auto-insurance-companies/.

[5] Wells, Andrea, "Nonstandard Auto Insurance Market is not for everybody," Insurance Journal, April 13, 2015, https://www.insurancejournal.com/news/national/2015/04/13/364065.htm

[6] Roughly 40% of enlisted Service members (60% of Marines) are age 24 or less. Reynolds, George M. and Shendruk, Amanda, "Demographics of the U.S. Military," Council on Foreign Relations, 2017, April 24, 2018; https://www.cfr.org/article/demographics-us-military

North Carolina Auto Dealers Association
Analysis of Sample of Claims paid by GAP policy

Prepared February 8, 2018

US Serviceman #1

- 20 year old E-3 purchased new 2016 Chevy Malibu on 4/9/2016.
- Financed for 84 months @ 7% monthly payment $470.42.
- Amount financed $31,035.02 ($500 cash down, $2000 rebate, no trade)
- Vehicle involved in a collision and declared total loss on 3/31/2017.
- 10 payments posted to account at time of total loss.
- **GAP payment $7,897.74**

US Serviceman #2

- 32 year old E-7 purchased preowned 2012 GMC Acadia on 10/20/2015.
- Financed for 72 months at 4.14% monthly payment $537.28
- Amount financed $33968.61 (no money down, $300 trade equity).
- Vehicle involved in a collision and declared total loss on 7/30/2017.
- 14 payments posted to account at the time of total loss.
- **GAP payment $6,743.23**

US Serviceman #3

- 19 year old purchased preowned 2009 Infiniti G37 on 07/02/2015
- Financed for 72 months @ 9% monthly payment $396.88.
- Amount financed $21950 (no money down, no trade.)
- Vehicle involved in front/side impact on 12/25/2016 resulting in total loss.
- 17 payments posted to account at time of total loss.
- **GAP payment $4,802.89**

US Serviceman #4

- 20 year old E-4 purchased preowned 2014 Mazda 3 on 02/22/2016
- Financed for 54 months @ 4.74% monthly payment $366.71
- Amount financed $17766.23 (money down$1340.68, $2930.91 negative in trade).
- Vehicle involved in collision and reported total loss on 03/31/2017.
- 12 payments were posted to account at time of total loss.
- **GAP payment $3,570.55**

US Servicewoman #1

- 29 year old E-6 purchased new 2015 Chevy Malibu on 05/18/2015
- Financed for 72 months at 3.69% monthly payment $522.73
- Amount financed $33663.98 (no money down, $3250 rebate).
- Vehicle involved in sideswipe collision on 05/01/2017 and declared total loss.
- 23 payments posted to account at the time of total loss.
- **GAP payment $6,706.88**

US Servicewoman #2

- 23 year old E-5 purchased preowned 2013 Mazda 3 on 8/22/2016
- Financed for 66 months at 3.3% monthly payment $263.81
- Amount financed $15881.88 (no money down, no trade).
- Vehicle reported stolen on 04/01/2017 and gap claim was filed.
- 6 payments were posted to account at time of gap claim.
- **GAP payment $3,158.48**

Attachment 2

Summary Bullet Points

· If GAP product is purchased, the average GAP benefit is around $3,000.
· If GAP product is not purchased, the average outstanding princpal balance owed after insurance is roughly $2,400.
· Since the recent MLA changes, contracts purchased in 2018 without GAP have realized an average outstanding princpal balance of around $2,800, after insurance proceeds.

	# of Contract Purchases	Avg Principal Balance at Date of Loss	Avg GAP Benefit after Insurance	Avg Remaining Principal Balance after Insurance (no GAP benefit)
Contract Purchases with GAP Product	1,258	$ 16,062	$ 3,046	
Contract Purchases with No GAP Product	296	$ 13,608		$ 2,362

Note: includes contract dates from 2015 through 2017, Totaled account with Date of Loss through Dec 2018, and insurance proceeds received

For contracts purchased from 2015 through 2017, number of totaled accounts increased 5% (1,476 to 1,554) from 10/31/18 through 12/31/18.
This group of contracts has an average age of 30 months, with the oldest being 48 months and newest being 12 months from origination date.

Since Recent MLA Changes (2018 contract purchases and with total insurance loss)

	# of Contract Purchases	Avg Principal Balance at Date of Loss	Avg GAP Benefit after Insurance	Avg Remaining Principal Balance after Insurance (no GAP benefit)
Contract Purchases with GAP Product	0			
Contract Purchases with No GAP Product	117	$ 16,171		$ 2,817

Note: includes contract dates from Jan 2018 through Dec 2018, Totaled account with Date of Loss through Dec 2018, and insurance proceeds received

For contracts purchased in 2018, number of totaled accounts increased 43% (82 to 117) from 10/31/18 through 12/31/18.
This group of contracts has an average age of 7 months, with the oldest being 12 months and newest being 1 month from origination date.

Attachment 3

Military Service Member Impact

Estimated 2018 Purchases	Total Loss% *Industry Avg. 3%-7%	Totaled Units	Estimated Balance Due after Insurance
200,000	5%	10,000	$30 Million

- The studied military segment shows total loss % exceeding 10%, therefore the extrapolation of debt owed by service members could be even higher than is presented above.
- The military market demographic leans towards younger male drivers where total loss % rates are higher. This is validated as younger male drivers carry higher insurance premiums compared to the standard population due to higher risk.

If GAP were available:

Industry Avg of contracts purchased with GAP	Accounts that would have had GAP	GAP benefit that would have reduced debt owed
50%	5,000	$15 Million

- Had GAP been available on contracts in 2018, $15 million of debt owed by servicemembers would have been covered by GAP.
- The studied military segment shows GAP purchase % of nearly 75%, therefore the extrapolation of savings to servicemembers could be even higher than is presented above.

GAP programs offered by standard insurance carriers have limitations on a number of vehicle and customer attributes that limit their coverage and availability.

Attachment 4

Department of Defense					
Active Duty Military Personnel by Rank/Grade					
November 30, 2018					
Rank/Grade	Services				Total Services
	Army	Navy	Marine Corps	Air Force	
TOTAL OFFICER	91,433	54,600	21,507	62,626	230,166
E-9	3,521	2,630	1,597	2,618	10,366
E-8	10,504	6,588	3,873	5,087	26,052
E-7	36,260	21,219	8,761	25,598	91,838
E-6	54,437	48,614	15,426	39,744	158,221
E-5	66,470	67,518	25,956	60,889	220,833
E-4	104,384	52,202	35,529	52,356	244,471
E-3	50,511	44,943	42,806	55,208	193,468
E-2	25,714	15,411	18,835	6,884	66,844
E-1	24,187	13,063	11,710	10,407	59,367
TOTAL ENLISTED	375,988	272,188	164,493	258,791	1,071,460
CADETS-MIDSHIPMEN	4,557	4,450	0	4,249	13,256
GRAND TOTAL	471,978	331,238	186,000	325,666	1,314,882