

# Client Alert

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## Department of Defense Publishes Amends and Adds Further Guidance on Military Lending Act Regulations

By **Obrea O. Poindexter, Trevor R. Salter, and Calvin D. Funk**

On December 14, 2017, the Department of Defense (“DOD”) published final interpretive rules (the “2017 Interpretive Rule”) amending previously issued interpretive rules on the Military Lending Act (“MLA”). The 2017 Interpretive Rule amends and replaces three specific questions and answers in the interpretive rules issued by the DOD in August 2016 (the “2016 Interpretive Rule”), while also adding a new question. Although the 2017 Interpretive Rule clarifies several ambiguities in the regulation, the limited scope of the Rule leaves many questions unanswered.

### BACKGROUND

In July 2015, the DOD published sweeping changes to its rules implementing the MLA (“MLA Final Rule”).<sup>1</sup> However, as industry participants studied the MLA Final Rule, many ambiguities were identified. Morrison & Foerster, along with several major trade associations, urged the DOD to clarify the ambiguities, and in response, the DOD issued the 2016 Interpretive Rule.<sup>2</sup> Nevertheless, industry groups continued to seek further clarity, given the MLA Final Rule’s effective date in October 2017.

### CLARIFICATIONS MADE BY 2017 INTERPRETIVE RULE

#### ***Exempt Credit Transactions***

The MLA Final Rule exempts certain kinds of credit transactions, including loans to finance the purchase of personal property or a motor vehicle when the loan is secured by that property. Industry participants sought clarification as to whether hybrid purchase money/cash advance loans are exempt from the MLA regulations. In the 2016 Interpretive Rule, the DOD indicated that a credit transaction would not be exempt where a creditor makes a purchase money loan secured by personal property, but simultaneously extends credit greater than the purchase price.

The 2017 Interpretive Rule amends the earlier guidance by indicating that a transaction may be exempt if the additional credit extended above the purchase price of the personal property or motor vehicle is used to finance costs expressly related to the property or vehicle being purchased. Examples of costs expressly related to the property would include an extended warranty, delivery costs, or installation costs. However, the transaction would not be exempt if the additional credit above the purchase price is used to finance GAP insurance or credit insurance.

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<sup>1</sup> Our client alert on the MLA Final Rule is available at <https://media2.mofo.com/documents/150731militarylendingact.pdf>.

<sup>2</sup> Our client alert on the 2016 Interpretive Rule is available at <https://media2.mofo.com/documents/160826-department-defense-military-lending.pdf>.

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## ***Taking of Security Interests and Preemption***

A plausible reading of the language in the MLA Final Rule left many lenders questioning whether the MLA Final Rule prohibited a creditor from taking a security interest in connection with a credit extension. In the 2016 Interpretive Rule, the DOD attempted to clarify that covered borrowers may convey security interests in check, savings, or other financial accounts, but the language was ambiguous about whether other laws could restrict a creditor's ability to take a security interest. The 2017 Interpretive Rule provides that, although the MLA permits borrowers to convey security interests for all types of consumer credit covered by the MLA, the MLA does not preempt state or federal laws that restrict or prohibit conveyance of security interests.

The 2016 Interpretive Rule also attempted to clarify that the MLA Final Rule's restriction on a creditor using a check or other method of access to a financial account does not prohibit a creditor from exercising a statutory right to take a security interest in funds deposited in a borrower's account. In addition, the 2017 Interpretive Rule goes on to provide that the MLA does not prohibit a creditor from exercising a contractual right to take a security interest where the right was granted to the creditor by the borrower.

## ***Safe Harbor for Covered Borrower Status Check***

In addition, the 2017 Interpretive Rule adds new guidance with regards to the timing for completing a covered borrower status check that satisfies the safe harbor in the MLA Final Rule. The MLA Final Rule creates a safe harbor with respect to determining whether a consumer is a covered borrower if the creditor checks a consumer's status against the DOD database or a nationwide consumer reporting agency. The MLA Final Rule specifies that to meet the safe harbor, the determination based on the status check must be completed at the time the consumer applies for credit "or 30 days prior to that time."<sup>3</sup> The language of the MLA Final Rule could be read to indicate that the status check must occur exactly at the time of application for credit, or exactly 30 days prior to such time. The 2017 Interpretive Rule clarifies that the MLA Final Rule creates a 30-day window within which the status check must occur.

## **ALL CLEAR?**

Despite these additional clarifications from the DOD, industry groups have indicated that they still have questions remaining about various aspects of the MLA Final Rule. However, it is not clear whether and how the DOD will respond to additional requests for clarification of the MLA Final Rule.

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<sup>3</sup> 32 C.F.R. § 232.5(b)(3)(i); see also 32 C.F.R. § 232.5(b)(3)(ii).

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