



May 11, 2017

Mr. Andrew Cohen  
Acting Director, Financial Readiness  
U.S. Department of Defense  
1400 Defense Pentagon  
Washington, DC 20301

Re: Follow-up Data on Impact of Military Lending Act Regulation on Credit Union Lending

Dear Mr. Cohen:

On behalf of America's credit unions, the Credit Union National Association (CUNA) and the Defense Credit Union Council (DCUC) are writing to the U.S. Department of Defense (DoD) to provide data illustrating the impact of the DoD's Military Lending Act (MLA) regulation on credit unions and their ability to lend to their military members. CUNA represents America's credit unions and their 110 million members. DCUC represents a total membership of nearly 190 military affiliated credit unions and their 23 million members, the vast majority of which operate on military bases worldwide and all of which support the military and civilian personnel of the DoD.

In a February 2017 letter, CUNA notified the DoD that we were in the process of collecting data that would demonstrate the adverse impact the MLA regulation is having on some credit unions' ability to lend to servicemembers and their families. Specifically, CUNA's Economics Department combed through National Credit Union Administration (NCUA) regulatory call report data to determine the extent to which credit unions have been forced to discontinue certain products directly covered by the MLA regulation. In addition to examining call report data, we surveyed our credit union membership on whether and how the MLA regulation has affected the safe and affordable products and services they are able to offer their members, including servicemembers. We completed our data collection shortly after the end of the first quarter of this year.

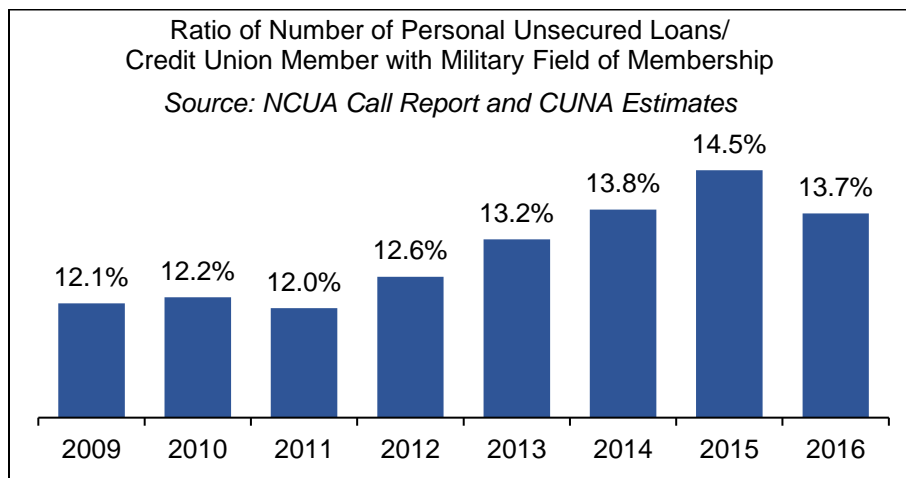
This letter shares the relevant findings from our data collection and offers suggestions the DoD can implement to reduce or eliminate the adverse impact the MLA rule is having on servicemembers and their dependents. The DoD has existing statutory authority to make the changes to the rule suggested below. We encourage the DoD to make such changes

via an interim final rule, which would provide for a quicker rulemaking timeframe while also allowing the DoD to accept input on the changes.

## **NCUA CALL REPORT DATA**

CUNA's Economics Department reviewed NCUA call report data between 2009 and 2016 for credit unions with significant military membership to determine the ratio of the number of personal unsecured loans per member.

As shown in the table below, between 2011 and 2015 the ratio increased steadily from 12.0% to 14.5%. Based on this trend and with continued improvement in economic conditions, we would have expected the demand for loans to continue to rise. We estimated the ratio would continue to rise to 15.2% for 2016, yet the ratio decreased to 13.7%.



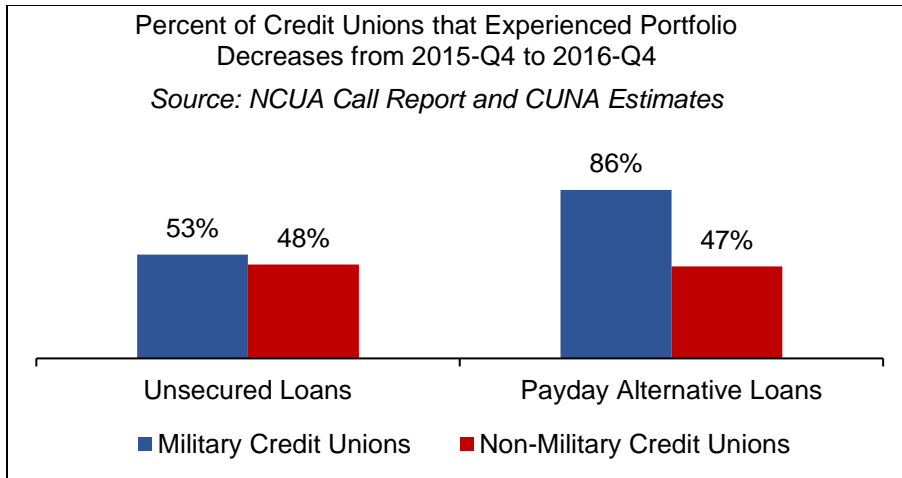
As noted in the table below, CUNA also compared the changes in loan portfolios for unsecured loans and Payday Alternative Loans (PALs)<sup>1</sup> at military credit unions and non-military credit unions.

Forty-eight percent of non-military credit unions experienced a decreased in their unsecured loan portfolios between fourth quarter 2015 and fourth quarter 2016, whereas 53% of military credit unions experienced a decrease in their unsecured loan portfolios during this same time-period.

Even more significant, while only 47% of non-military credit unions experienced decreases in their portfolios for PALs between fourth quarter 2015 and fourth quarter 2016, 86% of military credit unions experienced decreases in their portfolios for PALs during this same time-period.

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<sup>1</sup> Federal credit unions are permitted to make certain short-term, small dollar loans that meet strict lending criteria under the NCUA's PAL program. 12 C.F.R. § 701.21(c)(7)(iii) (2015).



We believe these two instances demonstrate that the MLA rule is having an adverse impact on lending to servicemembers as a result of certain provisions of the DoD’s regulation.

**CUNA’S MLA SURVEY**

CUNA solicited data between March 9 and March 30, 2017, via an online survey of lending and compliance personnel at over 3,500 credit unions of all asset sizes. We received a total of 615 survey responses, which represents an estimated response rate of 18% of credit unions, well above industry standards.

***The MLA Rule is proving burdensome to a majority of credit unions.*** Almost 60% of respondents stated that the MLA rule is either “very difficult” (15%) or “somewhat difficult” (43%) to comply with.

***The MLA Rule and Official Interpretations need to be better clarified.*** Roughly 60% of responding credit unions either “moderately” (32%) or “strongly” (27%) believe the MLA rule and accompanying MLA guidance is unclear and needs further clarification.

**Share-Secured Loans**

As we stated in our February 2017 letter to the DoD, share-secured loans (secured by funds deposited both before and after the loan is established) have traditionally been beneficial for servicemembers since they are made at interest rates below those of non-secured loans. Further, share-secured loans permit servicemembers to build positive credit ratings in relatively short time periods. This applies equally to lines of credit, closed-end loans, and credit card accounts.

However, current requirements under MLA section 232.8(e)(3) prevent many credit unions from offering share-secured loans to servicemembers and their dependents for a number of reasons, including that certain core processors used by credit unions do not permit a share-secured loan to be established using only funds deposited *after* the loan

is established. Therefore, this section of the MLA rule is harmful to servicemembers and their dependents because it deprives them of access to relatively low interest rate loans that would help build positive credit ratings.

The results of CUNA's MLA survey confirm the harm to servicemembers. Five percent of responding credit unions—which represents approximately 290 credit unions nationwide—indicated they have been forced to cut back on share-secured loans due primarily to the burden of the MLA rule. Another 11% of respondents—which represents approximately 635 credit unions nationwide—stated they have been forced to cease offering share-secured loans to either servicemembers or to their entire membership as a result of the burden of the MLA rule.

The impact of the rule goes beyond share-secured loans. For example, one credit union stated it would no longer be able to offer covered borrowers share-secured credit cards, which is typically offered to individuals with poor credit scores, who may have limited options for other credit. A share-secured credit card provides such an individual with the convenience of using a credit card while at the same time helping to improve that individual's credit rating.

Based on our calculation, the number of active duty servicemembers and their dependents potentially harmed by the reduction or elimination of share-secured loans provided by credit unions is roughly 161,100. Further, we estimate the number of reserve personnel and their dependents potentially harmed by these changes to share-secured loans provided by credit unions to be around 100,500.

The number of individuals harmed by the unanticipated consequences of the MLA rule could be reduced or eliminated if the DoD were to amend section 232.8(e)(3) to permit security interests in deposits made both *before* as well as *after* the loan is established.

### **Vehicle Loans**

As stated in our February 16 letter to the DoD, many credit unions participate in indirect dealer automobile loan relationships where a credit union either purchases or assumes a purchase-money vehicle loan originally made by an auto dealer. A credit union that purchases or assumes such a loan takes the loan subject to the claims or defenses a covered borrower can assert against the auto dealer under the Federal Trade Commission's Holder-in-Due-Course Rule.<sup>2</sup> If it is later determined by the credit union's regulator or a court of law that a particular loan was in fact covered by the MLA rule and the auto dealer failed to comply with the MLA rule, the credit union could be held liable for the auto dealer's failure to comply.

The fact that vehicle purchase-money loans are exempt from the MLA requirements negates any concern that an automobile dealer would fail to comply with the MLA requirements and therefore negates the risk that a credit union that purchases or

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<sup>2</sup> 16 C.F.R. § 433 (1977).

assumes such loans would be held liable under the Holder-in-Due-Course Rule for the auto dealer's actions.

However, question #2 from the DoD's August 2016 MLA guidance introduced a great deal of uncertainty regarding a purchase-money vehicle loan's continued exemption from the MLA rule. Question #2 failed to clearly define the situations under which a purchase-money vehicle loan would lose its exemption from the MLA rule's requirements.

Purchase-money vehicle loans are risky for credit unions because of the uncertainty regarding their continued exemption from the MLA rule. The DoD could reduce this risk by providing guidance that clearly defines all situations relating to cash-out, negative equity trade-ins, and expenses involved in the loan that would cause it to lose its exemption from the MLA rule's requirements.

Once this guidance is available, credit unions and auto dealers will be able to determine with a much higher degree of certainty whether a particular vehicle loan is exempt from the MLA rule. Further, in situations where the loan would be covered by the MLA rule, such guidance would help credit unions and auto dealers ensure compliance with the rule.

Unfortunately, CUNA's MLA survey confirms that a number of credit unions realize the high degree of risk currently associated with dealer loans and have opted to discontinue making indirect dealer loans. Over 2% of credit unions—which represents approximately 135 credit unions nationwide—have discontinued making indirect dealer vehicle loans. The number of active duty servicemembers and their dependents potentially harmed by the elimination of indirect dealer vehicle loans could be as high as 30,300 and the potential harm to reserve personnel and their dependents could be as high as 14,600.

Furthermore, the DoD's position (framed in question #2 of its Official Interpretations) that a purchase-money vehicle loan with a negative-equity trade-in loses its exemption under the MLA rule, completely ignores the reality of the situation and tends to harm servicemembers.

If a servicemember decides to purchase a new vehicle without using his or her current vehicle as a trade-in because of its negative equity, the servicemember will continue making payments on the current vehicle until the loan is paid in full and will begin making payments on the loan for the new vehicle as well. The servicemember will be making payments on two loans concurrently.

Yet, the creditor for the purchase-money vehicle loan will not have to comply with the MLA rule because the purchase-money loan is exempt from the rule.

If the servicemember instead wishes to use the current vehicle as a trade-in, the negative equity is currently considered as cash-out, and the new vehicle loan would lose its exemption from the MLA rule. However, even with the negative equity rolled into the new

loan, the combined loan payment is likely to be less than the total of the two loan payments in the first example.

Therefore, in the situation described in the second example, the servicemember benefits from the lower combined loan payment, while the creditor is forced to incur additional costs and risk in complying with the MLA rule.

As mentioned previously, some credit unions have eliminated indirect-dealer vehicle loans and purchase-money vehicle loans because of the impact of the MLA rule, particularly with regard to the uncertainty involving negative-equity trade-ins.

Our research has indicated that some credit unions are put in the unfortunate position of having to refuse to make a loan to a servicemember if the loan involves a negative-equity trade-in, while others will only make loans to a servicemember if that loan is exempt from the MLA rule.

To help reduce or eliminate the harm to servicemembers, CUNA urges the DoD to reconsider its position regarding negative-equity trade-ins and further urges the DoD to amend the MLA rule to permit purchase-money vehicle loans to retain their exemption from the MLA rule even when the purchase involves a negative-equity trade-in.

### **Other Loan Types Adversely Affected by MLA Requirements**

CUNA's MLA survey indicated that, in addition to share-secured loans and indirect-dealer vehicle loans discussed above, approximately 5% of credit unions—which represents approximately 290 credit unions nationwide—have been forced to eliminate other loan products from their loan portfolios as a result of the MLA rule, including unsecured lines of credit, overdraft protection lines of credit, PALs, and credit cards.

The number of active duty servicemembers and their dependents potentially harmed by the elimination of these additional types of loans is approximately 50,350 and the potential harm to reserve personnel and their dependents is roughly 31,400.

***Payday Alternative Loans.*** The harm to servicemembers caused by the elimination of PALs can be mitigated by providing a complete exemption from the DoD's MLA rule for PALs made under the NCUA's PAL program.

***Overdraft Protection Lines of Credit.*** Overdraft protection loans are an important option for credit union members, including servicemembers, because these loans typically protect a member's checking account from overdrafts and overdraft fees, and the alternative options may include illegal or predatory lenders. Unfortunately, a number of credit unions have eliminated overdraft protection lines of credit because of the burden of complying with the MLA rule.

The DoD can mitigate the harm to servicemembers caused by the elimination of overdraft protection loans by exempting such loans from the MLA rule.

## **GUIDANCE ON CREDIT CARD PROVISIONS OF MLA RULE**

In addition to addressing the issues above, we reiterate our call for the DoD to provide guidance specific to the MLA rule's provisions on credit cards. While the information in the guidance issued in late August of last year was helpful, the fact that it was issued so close to the effective date of the MLA rule made it less useful for financial institutions attempting to comply with the rule in time.

We ask that the DoD issue credit card guidance a minimum of four months prior to the effective date, which is currently October 3, 2017. If the DoD is unable to issue guidance in this timeframe, it should delay the effective date of the credit card provisions to provide a period of at least four months between the date of issuance of the guidance and the effective date. Financial institutions and their vendors need more than the five weeks afforded them following issuance of the DoD's August 2016 MLA guidance to make the numerous changes necessary to comply with the regulation.

## **CONCLUSION**

On behalf of America's credit unions and their 110 million members, we thank you for considering our concerns and ask you to pursue clarification on these issues. The call report data and survey results suggests that affordable loans from credit unions have become less accessible to servicemembers as a direct result of the MLA rule. As an unintended consequence, servicemembers who are also members of a credit union that has discontinued certain loans due to the MLA rule, are forced to borrow elsewhere at higher costs. Instead of being able to turn to their credit union, which is likely one of their safest and most affordable options for credit, they may end up turning to illegal online and offshore, or other predatory lenders. If you have questions about our comments or would like to discuss them in person, please do not hesitate to contact either of us.

Sincerely,



Jared Ihrig  
Chief Compliance Officer  
CUNA



Roland A. Arteaga  
President & CEO  
DCUC

Cc: Honorable J. Mark McWatters, Acting Chairman, NCUA  
Mr. Paul Kantwill, Assistant Director for Servicemember Affairs, CFPB