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# The Military Lending Act May Not Let Service Members Protect Against Mayhem

BY COLONEL JOHN LORAN KIEL, JR.

If you haven't purchased a new vehicle since 2017, there are some things you definitely need to know about the Military Lending Act (MLA) that will save you a lot of heartache and financial distress.

## GUARANTEED ASSET PROTECTION (GAP) WAIVER

I recently purchased a new "Special Ops Edition" Chevy Silverado pickup truck from my brother who owns a Chevy dealership in Florida and was stunned to learn that every potential lender I contacted claimed that they were legally forbidden from offering me a guaranteed asset protection (GAP) waiver to forgive the balance of my loan in the event my truck got totaled in an accident. If you haven't purchased a new vehicle since 2017, there are some things you definitely need to know about the Military Lending Act (MLA) that will save you a lot of heartache and financial distress later on in the event mayhem decides to pay you a visit.<sup>[1]</sup>

This article will examine the purpose of the MLA and some of its key provisions, explain why lenders feel that they are forbidden from financing GAP waivers pursuant to the Department of Defense's (DoD) interpretation of the MLA, discuss why a GAP waiver can be extremely valuable to service members, and explain why purchasing a GAP waiver through a lender is the optimal way to secure such valuable protection for your vehicle.

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## THREE FIXES

The good news is, there are three easy ways to fix the DoD's interpretation of the MLA so that it no longer harms service members and their dependents. First, the Department could redact its interpretation in the 2017 interpretive guidance that created the harm in the first place. Second, the President could issue an executive order or direct the Secretary of Defense to withdraw the DoD's interpretation of the statute. Third, Congress could step in and amend the MLA to expressly permit dealerships and lenders to once again finance GAP waivers for service members, as they had done prior to 2017.

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## PURPOSE OF THE MLA

The Department of Defense implemented the Military Lending Act in 2006 in 32 CFR part 232.[2] The MLA generally protects service members and their dependents against certain types of lending practices. Congress and the DoD were concerned that predatory lenders like pay day loan and title loan companies posed a significant threat to military readiness and service member retention.[3] Every year, thousands of well-trained service members are booted out of the military after losing security clearances due to financial mismanagement.[4] From 2004 to 2013, the DoD estimates that an average of 54,293 Soldiers, Sailors, Airmen, and Marines were involuntarily separated from the service due to legal or standard-of-conduct related issues.[5] Approximately half of those (an average of 18,961 per year), were attributable to loss of a security clearance and of those, 80 percent were due to some sort of financial distress.[6] Based on this data and other underlying assumptions, the DoD estimates that it can continue to expect to separate 7,580 service members a year where financial distress is a contributing factor.[7] The average cost of each separation is approximately \$58,250 and climbing.[8] The 10-year cost to the DoD of involuntary separations due to financial distress is estimated to be between \$1.646 billion and \$3.769 billion.[9] It is understandable why Congress and the DoD wanted to curb certain lending practices that directly contribute to these eye-popping costs and the national security risks they pose. What is not so clear is the problem with GAP waivers the Department was specifically trying to address. In a moment, I will explain the irony of the DoD's decision to prohibit lenders from financing GAP waivers and how it actually contributes to the increasing number of service men and women separated from the military for financial mismanagement.

## WHO THE MLA PROTECTS

The MLA and the DoD's regulation implementing the MLA found in 32 CFR § 232, define a covered borrower as "a consumer who, at the time the consumer becomes obligated on a consumer credit transaction or establishes an account for consumer credit, is a covered member of the armed forces or a dependent of a covered member." [10]

Covered members of the armed forces include members of the Army, Navy, Marine Corps, Air Force, or Coast Guard on active duty under a call or order that does not specify a period of 30 days or less or who are on active Guard and Reserve Duty.[11]

The term dependent includes a covered member's spouse, children under the age of 21, children under the age of 23 if they are enrolled in college full-time, and any dependent for whom the member provides more than half of their support.[12] There are other relationships that may qualify under this definition for which practitioners need to be on the lookout, but for the sake of brevity, they are not discussed here.

## WHAT THE MLA PROTECTS AGAINST

The MLA provision of which service members are probably the most aware is the one prohibiting lenders from charging a military annual percentage rate (MAPR) greater than 36 percent interest with respect to consumer credit extended to a covered member or their dependents.[13] In addition to open and close-ended interest rate caps, the MLA also makes it unlawful for creditors to do any of the following:

- (1) Require the borrower to waive their right to legal recourse under any otherwise applicable provision of State or Federal law, including any provision of the Service Members' Civil Relief Act;
- (2) Require the borrower to submit to arbitration or imposing onerous legal notice provisions in the case of a dispute;
- (3) Demand unreasonable notice from a borrower as a condition for legal action;

- (4) Use a check or other method of access to a deposit, savings, or other financial account maintained by the borrower, or the title of a vehicle as security for the obligation;
- (5) Require as a condition for the extension of credit that the borrower establish an allotment to repay an obligation;
- (6) Prohibit the borrower from prepaying the loan or charging a penalty or fee for prepaying all or part of the loan; or
- (7) Rolling over, renewing, repaying, refinancing, or consolidating any consumer credit extended to the borrower by the same creditor with the proceeds of other credit extended to the same covered member or a dependent.<sup>[14]</sup>

Another valuable provision of the MLA requires creditors to provide information orally and in writing to the member or member's dependent stating the MAPR applicable to the extension of credit; any disclosures required under the Truth in Lending Act (TILA); and a clear description of the payment obligations the member or their dependent have incurred.<sup>[15]</sup>

### **PENALTIES FOR VIOLATING THE MLA**

Creditors are held criminally and civilly liable for violating one or more of the provisions discussed above. A creditor who knowingly violates the MLA is either fined as provided in title 18 of the U.S. Code, imprisoned for not more than one year, or both.<sup>[16]</sup> A creditor will be civilly liable to a covered member or their dependent for:

- (1) Any actual damage sustained as a result of a violation of the MLA, but not less than \$500 for each violation;
- (2) Appropriate punitive damages;
- (3) Appropriate equitable or declaratory relief; and
- (4) Any other relief provided by law.<sup>[17]</sup>

The MLA also provides for recovery of attorney's fees and costs in the event of a successful action to enforce civil liability. It is also worth mentioning that, by operation of law, any credit agreement, promissory note, or other contract prohibited under the MLA is contractually void from its inception.<sup>[18]</sup>

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### **DOD'S REVISIONS TO THE MLA**

In July 2015, the DoD published a final rule revision to 32 CFR § 232 that expanded application of the MLA to additional types of credit such as credit cards, deposit advance products, overdraft lines of credit, and certain types of installment loans.<sup>[19]</sup> This revision—among other things—updated the MAPR to include certain additional fees and charges, modified the required creditor disclosures, and modified the prohibition on rolling over, renewing, or refinancing consumer credit.<sup>[20]</sup>

### **INTERPRETATIVE GUIDANCE**

On December 14th 2017, the DoD issued “interpretative guidance” that included a section containing questions and answers about certain interpretations of the 2015 final rule revision. Section II of that guidance makes clear that “these questions and answers represent the official interpretations of the Department on issues related to 32 CFR § 232.”<sup>[21]</sup> The second question asked whether credit extended by a creditor to purchase a motor vehicle falls within the exception to consumer credit under 32 CFR § 232.2.<sup>[22]</sup> In response, the Department concluded that “a credit transaction that finances the object itself, as well as any costs expressly related to that object, is covered by the exceptions [to consumer credit] in § 232.3(f)(2)(ii) and (iii), provided it does not also finance any credit-related product or service.”<sup>[23]</sup>

The Department provided two concrete examples of additional costs “expressly related” to the vehicle that would fit

within the two exceptions of the regulation, like financing the purchase of optional leather seats or an extended warranty for service.[24] Additionally, the Department concluded that it would be permissible for a covered member to trade in a vehicle that has negative equity and then include in the purchase of the second vehicle financing to repay the credit on the trade-in.[25]

The DoD then declared that a credit transaction that finances a “credit-related product or service” (like GAP insurance coverage) rather than a product or service “expressly related” to the motor vehicle, does not fall within either of the exceptions in 32 CFR part 232(f)(2)(ii) or (iii).[26] Just like that, without notice, warning, or opportunity to comment, the automobile finance industry was left wondering whether it could continue to offer service members financing that complied with the MLA.[27] Needless-to-say, this decision continues to cause a lot of consternation within the auto finance industry and, more importantly, it continues to harm service members and their dependents.

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The DoD’s interpretations of the MLA are binding on creditors nationwide because Congress specifically granted the DoD various authorities to prescribe regulations, to carry out the law, and to determine the scope, terms, and conditions of the regulations.[28] Out of an abundance of precaution, lenders and dealers then are left with no alternative but to avoid selling GAP waivers to service members and their dependents in order to comply with the MLA, or rather, the DoD’s current interpretation of it.

#### **GAP CAN PROTECT AGAINST MAYHEM**

Guaranteed Asset Protection or GAP, really has one purpose—to protect the investment you made in your vehicle

if it is lost or destroyed through theft, accident, or natural disaster.[29] GAP is not an insurance policy. It is actually an addendum to your auto loan contract that essentially waives or cancels the remainder of the loan balance with your creditor.[30] Normally, GAP will cover the difference between what you owe on the loan and what your insurance company pays out for your collision or comprehensive coverage.[31] Some GAP products will even cover your insurance deductible.[32]

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Here is an example an automobile warranty company executive shared with my brother and me that took place recently in Colorado. An Airman went into one of the Nissan dealerships that this executive’s company owns in Colorado Springs. He purchased a brand new Nissan Frontier pickup truck for \$25,000. After factoring in the tax, tag, and title, some negative equity in his trade-in and an extended service warranty, his total financed amount on the loan was nearly \$35,000. Two days later, outside the gate of Peterson Air Force Base, an unmarked police car, speeding without its lights on, crashed into the truck and totaled it. Because the dealership was forbidden from financing a GAP waiver and because this Airman hadn’t purchased GAP coverage from his insurance company, he was on the hook for at least \$10,000. This number is approximate because insurance companies typically offer actual cash value for the vehicle which is almost always less than the original price paid for the truck. Here, if they’d offered him \$22,000 after depreciating its value, he would have been financially responsible for nearly \$14,000 to his lender. It is important to note, that most automobiles lose at least ten percent of their value the moment their new owner drives them off the lot.[33] Within the first year of ownership, most vehicles will depreciate on average 20 to 30 percent depending on make and model.[34]

## WHEN TO PURCHASE

So when does it make sense to purchase GAP coverage? A number of experts would recommend it if you:

- (1) Made a small down payment on a new car, or none at all;
- (2) Agreed to a loan term longer than 48 months (you will pay down the principal slower);
- (3) Drive a lot, which reduces the car's value more quickly;
- (4) Lease your car;
- (5) Bought a car that depreciates faster than average.<sup>[35]</sup>

## A GAP WAIVER IS THE WAY TO GO

There are essentially three ways to purchase GAP coverage: (1) through the dealership or lender as a one-time fee calculated into your monthly loan payment; (2) from your automobile insurer, as part of your regular insurance premium; or (3) or from a company that only sells GAP products.<sup>[36]</sup> Because of the DoD's current interpretation of the MLA, service members may only exercise the latter two options. However, these options have their pitfalls. First, insurance companies do not waive or cancel the remainder of your loan after they pay for the actual cash value of your car. For example, if I total my new Silverado, my insurance company, USAA, is only going to send me a check for the actual cash value of the truck plus 20%. That would probably cover a good deal of what I owe on my loan—but not all of it. I would likely pay a few thousand dollars out-of-pocket because of the extended service plan I also purchased and rolled into the loan cost. The typical cost of GAP coverage from an insurance company is around \$120 plus the cost of comprehensive and collision coverage.<sup>[37]</sup> Not only is GAP coverage from an insurance company not as valuable as a full GAP waiver/cancellation addendum from the lender or dealer, but purchasers may not remember to add it to their insurance coverage after they leave the dealership. This also inaccurately assumes most purchasers know that insurance companies offer GAP protection.<sup>[38]</sup> This is exactly what

happened to the Airman who totaled his truck in Colorado. When he learned that the dealer could not sell him a GAP waiver, he became upset and eventually left the dealership, not knowing about his other options. Nevertheless, he bought the truck. Two days later, mayhem struck, and he wasn't protected.

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Consumers can also purchase GAP coverage through a third-party company selling GAP products. The typical cost of buying such standalone coverage is somewhere around \$200 to \$300.<sup>[39]</sup> Again this is problematic for service members who don't know that such companies are out there or who don't remember to look for one after they leave the dealership and their vehicle is at risk on the road. The other issue is dealing with a third-party company trying to convince the purchaser to pay the balance of a loan that they did not write. These circumstances prove to be uncomfortable and contentious for both parties; arguments ensue, curse words fly, and the consumer is usually left with the short end of the stick.

Purchasing a GAP waiver from the dealer or lender may cost on average \$500 to \$700, but the convenience and the peace of mind it provides for a few dollars more is worth the price.<sup>[40]</sup> When my brother's finance manager handed my wife and I a disclosure and said "you have to sign this form because you are a service member and a service member's dependent" it made me feel like they were discriminating against us by telling us we could not buy a valuable product that every nonmilitary customer is free to buy. It wasn't the fault of anyone at the dealership though, they were all following a rule that appears to be nothing more than an

afterthought by the DoD, a rule that needlessly penalizes service members and their dependents. The irony is, that by singling out GAP insurance, the DoD has created a situation where service members are forced to buy lesser GAP coverage through insurance companies or third party companies. Not only does the DoD policy discriminate against service members and their dependents, it discriminates against automobile dealerships and lenders all over the country. Why should only insurance companies and small companies who provide GAP products exclusively benefit from the DoD's harmful interpretation of the MLA? The glaring answer is, they shouldn't.

As a legal assistance attorney who managed multiple legal assistance offices throughout my time in the Army JAG Corps, I know there are many Soldiers out on the road in brand new expensive cars and trucks that they cannot afford. The Army already separates Soldiers who cannot afford to pay their auto loans once they lose their security clearance due to financial mismanagement. The DoD policy has made the problem worse. Now, even if they manage to pay their loans on time, if a Soldier loses his or her vehicle due to accident, theft, or natural disaster, and they don't have a GAP waiver, they become one of the very statistics the Department has been desperately trying to prevent. Industry experts have aptly noted that service members are more likely to not obtain GAP coverage when there is no option to finance it into their monthly payments, thereby making them more susceptible to financial distress in the event their vehicle is lost or destroyed.[41] These experts are also concerned that the DoD's interpretation raises potential fair lending concerns in states that specifically prohibit discrimination against service members in commercial and other credit transactions.[42]

## HOW TO RIGHT THE WRONG

There are three ways to rectify the DoD's interpretation of the MLA. First, the President could force the DoD to rescind its interpretative guidance either through issuing an executive order or by directing the Secretary of Defense to clarify or rescind it.[43] Second, the DoD should, on its own volition, rescind this portion (question two) of its interpretive guidance for the reasons previously discussed. Finally, if all else fails, Congress should step in and amend the MLA by specifically authorizing covered members and their dependents to finance GAP waivers into their automobile loans as they previously had been able to do prior to December 2017. Fixing this problem would be a great opportunity for the DoD, the President, or Congress to prioritize helping our service members who sacrifice so much defending our freedoms every day.

## ABOUT THE AUTHOR

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## ENDNOTES

- [1] Mr. Mayhem is currently an advertisement campaign run by Allstate insurance company. Allstate began running its mayhem commercials in April 2010. See Steve Johnson, *Behind the Scenes with Allstate's Mayhem Man*, CHICAGO TRIBUNE, June 1, 2011, <http://www.chicagotribune.com/news/ct-xpm-2011-06-01-ct-live-0602-allstate-mayhem-ads-20110601-story.html>.
- [2] 10 U.S.C. § 987 (2006).
- [3] FDIC Compl. Examination Man., Part V, sec. 13.1 (2016).
- [4] Limitations on Terms of Consumer Credit Extended to Service Members and Dependents, 80 Fed. Reg. 43560, p. 73 (Jul. 22, 2015).
- [5] *Id.*
- [6] *Id.*
- [7] *Id.* at 74.
- [8] *Id.*
- [9] *Id.*
- [10] FDIC Compl. Examination Man., Part V, sec. 13.2 (2016); 32 C.F.R. § 232 (2018).
- [11] 10 U.S.C. § 987 (2006).
- [12] FDIC Compl. Examination Man., Part V, sec. 13.2 (2016).
- [13] 10 U.S.C. § 987 (2006).
- [14] *Id.*
- [15] *Id.*
- [16] *Id.*
- [17] *Id.*
- [18] *Id.*
- [19] This did not include installment loans 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. See FDIC Comp. Examination Man., Part V, sec. 13.3 (2016)
- [20] *Id.*
- [21] *Military Lending Act Limitations on Terms of Consumer Credit Extended to Service Members and Dependents*, FEDERALREGISTER.GOV (Dec. 14, 2017), <https://www.federalregister.gov/documents/2017/12/14/2017-26974/military-lending-act-limitations-on-terms-of-consumer-credit-extended-to-service-members-and>.
- [22] *Id.*
- [23] *Id.*
- [24] *Id.* The Department really meant to say here, “extended service contract”, as there is legally no extension of the original service warranty.
- [25] *Id.*
- [26] *Id.* The Department’s repeated use of the term “GAP insurance” also indicates that is not fully aware of what these products are that they indiscriminately banned. A GAP waiver or cancellation provision is part of the addendum to the original finance contract and is not an insurance policy.
- [27] Rachel R. Mentz, *Trump Administration Plans to End Military Lending Act Prohibition on Offering GAP Insurance to Service Members in Auto Loan Transactions*, Consumer Fin. Monitor (Aug. 21, 2018), <https://www.consumerfinance.com/2018/08/21/trump-administration-plans-to-end-military-lending-act-prohibition-on-offering-gap-insurance-to-service-members/>.
- [28] 80 Fed. Reg. 43560 (Jul. 22, 2015).
- [29] *Mind the GAP: When to Consider Guaranteed Asset Protection for Your Loan*, Securian Financial, <https://www.securian.com/insights-tools/articles/mind-the-gap.html> (last visited Jan. 11, 2019).
- [30] *Id.*
- [31] *Id.*
- [32] *Id.*
- [33] *Id.*
- [34] *Gap Insurance: What is it and Who Needs it*, Nerdwallet, <https://www.nerdwallet.com/blog/insurance/car-insurance-basics/is-gap-insurance-worth-it/> (last visited Jan. 11, 2019).
- [35] *Id.*
- [36] *Id.*

[37] *Id.*

[38] *The 4 Best Gap Auto Insurance Providers*, Cars Direct, <https://www.carsdirect.com/car-insurance/the-4-best-gap-auto-insurance-providers> (last visited Sep. 10, 2019).

[39] *Id.*

[40] *Id.*

[41] Rachel R. Mentz, *supra* note 27.

[42] *Id.*

[43] *Id.*