



August 26, 2022

Governor Gavin Newsom
1021 O Street, Suite 9000
Sacramento, CA 95814

Re: SB 1311, Concerns Over Service Member's Access to Valuable Credit Protection

Dear Governor Newsom:

The undersigned organizations, representing the majority of the lenders and stakeholders providing consumer voluntary protection products, respectfully submit our concerns over Senate Bill 1311. Particularly, while we support protections for military families and thus SB 1311 in total, we are concerned that Section 5 of SB 1311 creates unintended consequences that will harm service members by preventing access to GAP waiver and other credit-related ancillary products.

I. Introduction

GAP waiver provides an important protection against the potential financial burden of excess car loan repayment in the event of total loss. Often, when a car is totaled the insurance payout does not cover the balance of the loan. GAP covers all or part of the difference between the loan balance and the book value of the vehicle at the time of the loss. In a recent study, more than 93% of GAP purchasing consumers indicated GAP was a good idea.¹ Nearly 40% of American households have indicated an unforeseen \$400 expense would be difficult to handle.²

¹ See "Consumers and Guaranteed Asset Protection ("GAP Protection") on Vehicle Loans and Sales-Financing Contracts: A First Look," by Thomas A. Durkin, Senior Economist, Board of Governors of the Federal Reserve System (retired), Gregory Elliehausen, Principal Economist, Board of Governors of the Federal Reserve System, and Thomas W. Miller, Jr., *Professor and Jack R. Lee Chair in Financial Institutions and Consumer Finance*, Mississippi State University, Senior Research Fellow, Consumers' Research, September 2021

² Board of Governors of the Federal Reserve System, "Report on the Economic Well-Being of U.S. Households in 2020, May 2021

Couple that with data showing 44% of trade-in vehicles had negative equity in 2020 and it is clear why GAP is an important tool for consumer financial risk management.³

II. GAP Waiver Regulation in California

Another bill on your desk this year is Assembly Bill 2311. Industry worked closely with Assemblyman Maienschein's office and the Attorney General staff to develop a new statutory framework for GAP waivers. This bill includes important consumer protections such as cancellation at any time, loan-to-value ratio limitations, and clear refund procedures and penalties for violations of termination requirements. These statutory protections ensure the GAP waiver market in California continues to be fair to consumers and competitive.

III. MLA and Auto Loans

Since its inception, the Military Lending Act ("MLA") has exempted "a loan procured in the course of purchasing a car or other personal property, when the loan is offered for the express purpose of financing the purchase and is secured by the car or personal property procured."⁴ This important exemption exists because the MLA would otherwise prohibit the use of a vehicle title to secure a loan.⁵ If this were the case, it would be highly unlikely anyone would ever sell a car to a service member. The Department of Defense ("DOD"), in interpreting the statute, has recognized the potential risk of interpreting this limitation too narrowly.⁶ As such, the DOD issued several interpretive rules trying to clarify the relationship between car loans and the MLA.

IV. MLA and Voluntary Protection Products

On December 14, 2017, the DOD issued an interpretive ruling stating that 32 CFR 232.3(f)(2)(ii) (restricting the use of a vehicle title to secure an MLA loan) does not prohibit financing charges above and beyond the purchase price of the car where the expense is expressly related to the purchase of the vehicle.⁷ This includes things like optional leather seats, vehicle service contracts, and covering the remaining finance cost of a trade-in vehicle.⁸ However, at the time the DOD distinguished GAP and other credit related products or services, stating that these products would render a loan subject to the MLA.

GAPA and other industry leaders immediately responded to the DOD with concerns about how this new interpretation does not comport with a reading of the plain language of the statute, and importantly, that this would negatively impact service members and the industry.⁹

³ During the first nine months of 2019, 33% of people who traded in cars to buy new ones had average negative equity of \$5,000, a 74% increase from 10 years prior (Wall Street Journal, November 9, 2019). According to Edmunds, this increased to 44% of people with \$5,600 negative equity during the pandemic (Edmunds.com, "Negative Equity Is Surging During Coronavirus," May 2020).

⁴ 10 USC 987(i)(6)

⁵ 10 USC 987(e)

⁶ See the "Vehicle Title Restriction" paragraph at 80 Fed. Reg. 43,560, 43, 590 (Jul. 22, 2015) ("The Department finds that a comprehensive restriction against using the title of a vehicle as security for consumer credit would operate too severely against covered borrowers and, accordingly, exercises its authorities under the MLA to establish a reasonable limitation on this provision.")

⁷ Federal Register/Vol. 82, No. 239/Thursday, December 14, 2017/Rules and Regulations

⁸ *Id.*

⁹ See for example, NADA and AFSA Joint Letter Requesting Withdraw of Q&A2, January 18, 2018, available at (chrome-extension://efaidnbmnnnibpcajpcglclefindmkaj/https://www.financialservicesperspectives.com/wp-content/uploads/sites/44/2020/03/NADA-AFSA-Letter-to-DOD-1-18-18.pdf)

The industry emphasized that, regardless of any technical distinction, the net result of this ruling would be to completely deprive service members of GAP and other related products. Complying with MLA for a car loan with GAP coverage would require “extending unsecured financing for motor vehicle sales” which is “not economically viable.”¹⁰ Not to mention this would require many smaller entities to create MLA compliance mechanisms they may not be adequately equipped to handle. In light of these objections, the DOD withdrew the Dec 14, 2017 ruling.

V. SB 1311, GAP Waiver and the MLA

SB 1311, The Military and Veteran Consumer Protection Act of 2022, seeks to compliment and extend the MLA and its goal of protecting military service members. In spirit we couldn't agree more. However, we are concerned that section 5 of the bill will adversely affect that mission. Paragraph (c) of this section states that, “[a] security interest in a motor vehicle is void, and cannot be perfected, if it would cause a loan procured by a covered member in the course of purchasing the motor vehicle to be exempt from Section 987 of Title 10 of the United States Code, and the loan also funds the purchase of a credit insurance product or credit related ancillary product.” In effect, car dealerships will no longer be able to offer GAP waiver financing as part of a vehicle loan to service members. Although the mechanism might be different, we believe this will have a similar chilling effect as the DOD interpretive ruling and should be removed.

Senator Eggman's office has suggested the purpose of Section 5 is to prohibit the “bundling” of GAP Waiver and auto loans. It does not preclude the sale of GAP Waiver entirely but would require a cash purchase at the time of transaction, or a secondary transaction of the GAP product alone. Financing in the latter scenario would require an MLA compliant loan separate from the car financing loan. Offering voluntary protection products such as GAP at the time of vehicle purchase and financing is both a dealer and consumer convenience. Incorporating car related products into the loan extends consumers ability to purchase helpful products when they may be using most of their available cash on a down payment. We remain highly concerned that the costs associated with financing a separate MLA compliant transaction and the risks associated with rendering a security interest void if a bundled loan is mistakenly sold to a service member are too high and will have a chilling effect on the GAP market, thereby unnecessarily exposing California military households to financial setbacks.

It is ironic that this bill seeks to protect the financial interest of military service members by effectively banning voluntary credit protection products. The sale and marketing of these products by unscrupulous actors is as much a concern for our industry as it is the State. Assembly Bill 2311 was carefully crafted and negotiated to eliminate bad actors and protect consumers. Unfortunately, California service members will not be provided these critical consumer protections nor the benefits of the underlying products due to Section 5 of SB 1311.

VI. Conclusion

Due to the overall positive nature of SB 1311 for military and veterans' households, we do not wish to oppose this legislation in its totality, and we recognize a Gubernatorial veto is unavailable for this type of legislation. However, we do want to bring to your attention the irony of preventing service member access to GAP when a new statutory framework for GAP is expected shortly in your state. Having extensive experience with credit-related ancillary

¹⁰ *Id.*

products, our collective industries are well equipped to assess the impact Section 5 will have, and sadly we are confident in the end it will harm California military households. Hopefully we can remedy this in the future.

Respectfully submitted by the following organizations:

American Financial Services Association (AFSA)
American Property Casualty Insurance Association (APCIA)
California Bankers Association (CBA)
California Credit Union League (CCUL)
Consumer Credit Industry Association (CCIA)
Defense Credit Union Council (DCUC)
Guaranteed Asset Protection Alliance (GAPA)
Independent Auto Dealers Association of California (IADAC)
National Independent Auto Dealers Association (NIADA)