

Department of Defense Issues Final Rule Expanding Application of Military Lending Act

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The Department of Defense has issued its final rule (the “Rule”) expanding the application of the Military Lending Act and its implementing regulations (collectively referred to as the “MLA”). The final rule was published in the Federal Register today. *See Limitations on Terms of Consumer Credit Extended to Service Members and Dependents; Final Rule*, 80 Fed. Reg. 43,560 (July 22, 2015). The rule becomes effective on October 1, 2015, but creditors are not required to be in compliance with its requirements until October 3, 2016.

The Rule expands the scope of the MLA to apply to a number of additional consumer credit products previously outside the scope of the MLA, including unsecured installment lending and non-purchase money installment lending secured by motor vehicles and personal property. In addition, the Rule makes certain changes to the substantive requirements and the Safe Harbor protection under the MLA. These changes are discussed below.

Expansion of Scope

Prior to the Rule, the MLA applied only to certain payday loans, motor vehicle title loans, and tax refund anticipation loans. The Rule expands the MLA to now apply to any type of credit subject to the Truth in Lending Act and Regulation Z, which includes any credit offered or extended to a covered borrower primarily for personal, family, or household purposes that is subject to a finance charge or payable by a written agreement in more than four installments. However, the Rule maintains the MLA’s express statutory exclusion for a credit transaction secured by an interest in a covered borrower’s dwelling and a purchase money loan secured by a motor vehicle or other personal property. In addition, the Rule confirms that a credit transaction otherwise exempt from TILA (such as commercial loans or consumer loans in excess of the threshold amount, currently \$54,600) would not be subject to the MLA. As a result, once the Rule’s requirements take effect, the MLA will apply to unsecured loans and non-purchase money loans secured by personal property and motor vehicles of \$54,600 or less. The Rule also expands the definition of a creditor to include assignees of any consumer credit transaction subject to the MLA.

The Rule generally maintains the scope of the MLA’s application to covered borrowers, the definition of which includes all active duty military members, their spouses, and certain other dependents.

Overview of the MLA's Existing Requirements

The MLA's current requirements impose substantial restrictions on the limited credit products subject to its requirements when they are made to a covered borrower. First, the MLA imposes a number of substantive prohibitions on credit products subject to the MLA, including a prohibition on arbitration clauses, unreasonable notices required from the borrowers, and prepayment penalties. Second, the MLA requires specific disclosures be made for any credit product subject to the MLA. Third, a credit product subject to the MLA may not have a military annual percentage rate ("MAPR") greater than 36%. Finally, the MLA contains a safe harbor that creditors may use to determine whether the potential borrower is a covered borrower and thus whether the transaction is subject to the MLA. Each category is discussed in more detail below.

Substantive Prohibitions

The MLA imposes a number of substantive limitations on creditors making extensions of credit subject to the MLA, including prohibitions on required waivers, arbitration clauses, unreasonable notices required from the borrowers, agreements to pay by the military allotment system, and prepayment penalties. The Rule does not make many changes to these substantive limitations. However, the Rule did add a new exclusion to the existing prohibition on a creditor rolling over, renewing, repaying, refinancing, or consolidating any consumer credit previously extended by the creditor and subject to the MLA. Under the Rule, for this prohibition only, the definition of a creditor would only include a person engaged in the business of extending consumer credit to engage in deferred presentment transactions or similar payday loan transactions. As a result, this prohibition would remain effective only to creditors making such loans. In addition, the Rule adds one new substantive limitation applicable to all creditors extending credit subject to the MLA, as expanded by the Rule. Under this prohibition, a creditor may not use the title of a motor vehicle as security for an obligation subject to the MLA, provided that this limitation does not apply to a person who is chartered or licensed under federal or state law as a bank, savings association, or credit union. The remaining substantive limitations have not been substantively modified.

Required Disclosures

The Rule maintains the existing MLA disclosures relating to the requirement to provide a statement of the MAPR, but removes the separate requirement to provide a statement of the total dollar amount of all charges included in the MAPR. The Rule also provides additional clarification regarding the form of the statement of the MAPR. The statement must describe the charges that the creditor may impose, but is not required to describe the MAPR as a numerical value or to describe the total dollar amount of all charges in the MAPR that apply to the extension of consumer credit. A creditor may include a statement of the MAPR applicable to the consumer credit within the loan agreement or contract. The following model statement, or one substantially similar to it, may be used to satisfy the statement of the MAPR disclosure requirement:

Federal law provides important protections to members of the Armed Forces and their dependents relating to extensions of consumer credit. In general, the cost of consumer credit to a member of the Armed Forces and his or her dependent may not exceed an annual percentage rate of 36 percent. This rate must include, as

applicable to the credit transaction or account: the costs associated with credit insurance premiums; fees for ancillary products sold in connection with the credit transaction; any application fee charged (other than certain application fees for specified credit transactions or accounts); and any participation fee charged (other than certain participation fees for a credit card account).

The Rule also maintains the following disclosures already required under the MLA: (A) the disclosures required by Regulation Z; and (B) a clear description of the payment obligations of the member or dependent, provided that a payment schedule or account-opening disclosures provided pursuant to Regulation Z satisfies this requirement.

The Rule maintains the requirements relating to the form and delivery of the disclosures. Specifically, creditors must provide the above disclosures in a written form that a covered borrower may keep. In addition, the creditor must also provide the above disclosures, other than the disclosures required by the Truth in Lending Act, orally before consummation of the transaction. While the MLA currently provides for a modified oral disclosure process for extensions of credit made via the mail or the internet, the Rule simply provides that a creditor may satisfy the obligation to provide the disclosures orally either by providing the information to the borrower in person or by means of a toll-free telephone number in order to deliver the oral disclosures to a borrower when the borrower contacts the creditor for this purpose. The Rule also provides that if the creditor opts to provide the oral disclosures by means of the toll-free number, the toll-free telephone number must be included on either: (a) a form the creditor directs the borrower to use to apply for credit; or (b) the written disclosure the creditor provides to the borrower to comply with the requirement of written disclosures.

Calculation of the MAPR

The Rule maintains the existing 36% MAPR limitation on transactions subject to the MLA. However, it provides additional clarity on the calculation of the MAPR. Under the MLA, the following charges must be included in the finance charge for purposes of calculating the MAPR: (A) credit insurance premiums, including charges for single premium credit insurance, fees for debt cancellation or debt suspension agreements; (B) fees for credit-related ancillary products sold in connection with the transaction either at or before consummation; and (C) except for a bona fide fee that may be excluded: (i) finance charges; (ii) any application fee charged to a borrower (except that this limitation does not apply to a federal credit union or insured depository institution making certain small dollar loans); and (iii) any fee imposed for participation in any plan or arrangement for consumer credit (a “participation fee”). The Rule also amends the calculation methodology of the MAPR to include any fee imposed for participation in any plan or arrangement for consumer credit. For open-end credit, the amount of any charges related to the opening, renewing, or continuing an account must be included in the MAPR to the extent the charges would otherwise be included under the requirements described above. However, participation fees of up to \$100 per annum are permitted for open-end credit and reasonable, bona fide fees (other than a periodic rate) of any amount are permitted for open-end credit card accounts. The exclusion for bona fide fees for open end credit card accounts does not apply to credit insurance premiums or fees, debt cancellation or suspension fees, or any fee for a credit-related ancillary product. The Rule provides for a safe harbor calculation for determining whether a bona fide fee is reasonable.

The former version of the Rule expressly excluded late payment fees and taxes from charges that were included in the MAPR. The revised version of the Rule removes that express exclusion, but that should be seen as eliminating a redundancy rather than creating a substantive change to the MAPR calculation. The revised Rule excludes from the MAPR those charges that are excluded from being a finance charge under Regulation Z (such as late payment fees and taxes), which is sufficient for those charges to remain excluded from the MAPR calculation.

Identification of Covered Borrowers

The Rule makes a significant change to the manner of identifying whether a borrower is a covered borrower entitled to the protections of the MLA. Under the existing provisions of the MLA, a creditor is entitled to a safe harbor protection if it obtains a signed certification form from the potential borrower certifying that the individual is not a covered borrower. Under the Rule, the Safe Harbor is only provided if the creditor verifies the status of the applicant by accessing a database created for this purpose (referred to as the “MLA Database”) using the applicant’s last name, date of birth, and social security number. However, creditors are prohibited from using the MLA database to conduct a “look back” whereby they attempt to ascertain whether a borrower was a covered borrower as of the date of a previous transaction. A creditor may also verify the status of a potential borrower by using a statement, code, or similar indicator describing that status, if any, contained in a consumer report obtained from a consumer reporting agency or a reseller of such a consumer report. Under either methodology, the creditor is entitled to safe harbor protection.

The creditor must retain a record of the information obtained from the MLA database or the credit reporting agency. The creditor may make the determination and retain the records solely at the time: (i) the consumer initiates the transaction or 30 days prior to that time; (ii) the consumer applies to establish the account or 30 days prior to that time; or (iii) the creditor develops or processes a firm offer of credit that includes the status of the consumer as a covered borrower, as long as the consumer responds to that offer no later than 60 days after the time that the creditor provided the offer to the consumer.

Penalties

The Rule incorporates the MLA’s statutory penalties into the implementing regulations of the MLA. Accordingly, the penalty for knowingly violating the MLA may include an organizational fine of up to \$200,000 and up to a year in prison. The MLA also imposes general civil liability for violating the MLA of actual damages not less than \$500 per violation, appropriate punitive damages, other appropriate equitable and declaratory relief, any other relief provided by law, court costs, and attorney’s fees. In addition, any loan made in violation of the MLA or its implementing regulations is void at its inception. As a result, a creditor making a loan in violation of the MLA’s requirements would be liable for the above described penalties and would not be able to recover either the principal or interest relating to a transaction made to a covered borrower.

Conclusion

The Rule follows the Department of Defense’s proposed rule with respect to the majority of its requirements. In this respect, the Rule marks a significant expansion of the MLA and will force many creditors exclusively offering

products that were formerly beyond the scope of the MLA to now comply with the MLA's requirements. In addition, the modifications to the substantive prohibitions and the disclosure requirements will require creditors already subject to the MLA to modify their compliance policies and documents. Finally, the Rule's overhaul to the MLA's safe harbor provisions will necessitate a modification to the application process for all types of credit now subject to the MLA in order for creditors to avoid inadvertent liability under the MLA.

If you have further questions on these issues, please contact one of the authors or another member of our Consumer Financial Services team.

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