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DOD Proposes Significant Expansion of Military Lending Act Protections

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On September 29, 2014, the Department of Defense (DOD) published a proposed rule in the *Federal Register* to amend its regulation implementing the Military Lending Act (MLA), 32 C.F.R. Part 232, to significantly expand the scope of the MLA protections by reaching new types of creditors and credit products, including credit cards.¹ DOD says in the Supplementary Information that the proposal is the result of a statutory requirement in the MLA to consult with the Consumer Financial Protection Bureau (CFPB) and the federal banking agencies “not less often than once every two years” to determine whether the MLA implementing regulation should be amended.

The CFPB issued a press statement in which the agency said it “strongly supports” the DOD proposal. The CFPB’s strong statement of support may be an indication that the agency played a key role in developing DOD’s proposal. Creditors, especially credit card issuers, should study the proposal closely to understand how the proposed MLA requirements may impact their operations and could result in an additional compliance regime for service members and their spouses and dependents.

CURRENT REQUIREMENTS UNDER THE MLA

The MLA and its implementing regulation apply to active duty service members and their spouses or dependents. Generally, the MLA and its implementing regulation:

- Establish a maximum “military” annual percentage rate (MAPR) of 36 percent that may be charged on closed-end “consumer credit” transactions based on specified fees and charges that must be included in the MAPR, such as credit service and renewal charges, credit insurance premiums and fees for credit-related ancillary products sold as part of the credit transaction;
- Prohibit the use of arbitration or “other onerous legal notice provisions” with covered borrowers when disputes arise; and
- Require that certain disclosures be given orally and in writing, and mandate compliance with applicable disclosure requirements of Regulation Z.

Under the existing DOD regulation, the term “consumer credit” is defined narrowly to include only “payday loans,” “vehicle title loans” and “refund anticipation loans” that meet criteria established by the regulation. For example, under the current regulation, a payday loan is defined as a closed-end credit transaction with a term of 91 days or less in which the amount financed does not exceed \$2,000.

¹ Limitations on Terms of Consumer Credit Extended to Service Members and Dependents, 79 Fed. Reg. 58,602 (Sept. 29, 2014).

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OVERVIEW OF THE DOD PROPOSAL

General. Under the proposal, DOD would expand the scope of the MLA regulation by aligning its scope with that of the Truth in Lending Act and Regulation Z, with certain exceptions discussed below, including a proposed “conditional exclusion” for credit card accounts. Generally, Regulation Z applies if the credit is offered or extended primarily for personal, family or household purposes and is subject to a finance charge or payable by a written agreement in more than four installments. Under the proposal, a wide range of credit transactions that are subject to Regulation Z—including open-end credit and installment loans—would be subject to the MLA rule for the first time, unless the credit transaction falls within one of the exceptions specified in the proposal.

Calculating the MAPR. The proposal would establish a new calculation method for determining whether the 36-percent MLA interest rate limitation is met for both closed-end credit and open-end credit transactions by reference to Regulation Z. Under the proposal, creditors (including card issuers, as discussed in greater detail below) would have to determine which fees or charges are includable in the MAPR calculation and which fees or charges are not.

Under the proposal, the following fees or charges must be included in the MAPR:

- Credit insurance premiums and fees for debt cancellation or debt suspension agreements;
- Fees for “credit-related ancillary products” that are sold in connection with the credit transaction, either at or before consummation;
- Finance charges that are “associated with” the consumer credit, even if the charge would not be considered a finance charge under Regulation Z; and
- Application fees and “participation” fees, including annual fees.

Proposed Coverage Exceptions. Under the proposal, the following types of transactions would be exempt from the regulation:

- **Residential Mortgage Loans** – Any extension of credit that is secured by a covered borrower’s dwelling, including purchase money or construction loans, refinancing transactions, home equity loans (including HELOCs) and reverse mortgages.
- **Certain Secured Transactions** – Any loan that is “expressly intended” for financing the purchase of a motor vehicle or personal property, but only if the loan is secured by the vehicle or property being purchased.
- **Transactions Not Covered by Regulation Z** – Any credit transaction that is exempt from the requirements of Regulation Z, other than transactions subject to state law for which the CFPB has granted an exemption from the requirements of Regulation Z.

Special Rule for Credit Card Accounts. The proposal includes special rules for fees assessed for credit cards because, according to DOD, “imposing the [MLA interest-rate limitation] on credit card products likely would result in dramatic changes to the terms, conditions, and availability” of credit card accounts for service members and their families.² Despite

² 79 Fed. Reg. at 58,610.

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the proposed special rules for credit card accounts, whether credit card fees must be included in the MAPR calculation depends on the types of fees. Generally, for credit card accounts, only “bona fide” fees can be excluded from the MAPR calculation. However, even if an issuer’s MAPR is at or below the 36-percent rate cap, the issuer still would be subject to the prohibition on arbitration. As a result, the prohibition on arbitration would apply to all MLA-covered cardholder agreements.

The proposal establishes several tests for determining whether a fee qualifies as a bona fide fee, including a comparison of the creditor’s fees to fees imposed by other creditors. Under a “safe harbor” in the proposal, for example, a creditor can compare the amount of a fee to “an average amount for a substantially similar fee charged by 5 or more creditors,” each of whom has at least \$3 billion in outstanding loans. If the amount of the creditor’s own fee is less than or equal to the average of the amount charged by creditors in the comparative group, then the creditor’s fee would be considered “bona fide” and excludable from the 36-percent interest rate limitation calculation.

Under the proposal, fees for credit insurance premiums, debt cancellation or debt suspension agreements, and any fees for “credit-related ancillary products” associated with a credit card account must be included in the 36-percent interest rate limitation calculation.

In the Supplementary Information, DOD asks several questions regarding the proposed treatment of credit card accounts, including whether DOD should exclude credit card accounts in light of the requirements that already apply to such accounts under Regulation Z. DOD has also solicited comment on whether applying the MLA limitations on private-label credit cards would create “operational issues” and how “credit-related ancillary product” should be defined.

Use of the MLA Database. DOD is proposing to amend the regulation to create a “safe harbor” under which creditors could access the MLA Database to determine whether a consumer-applicant is a covered borrower (an active duty service member, spouse or dependent) under the regulation for a particular transaction. Use of the MLA Database would not be mandatory under the proposal—creditors could use “other methods” to determine whether an applicant is a covered borrower. In order to perform the search, a creditor would need the consumer’s last name, date of birth, and Social Security number. A query based on the MLA Database would be deemed “conclusive” with respect to a consumer’s status for a particular transaction, as long as that creditor maintains a record of the information obtained from the query. However, if a creditor has “actual knowledge” that a person is an active duty service member, the creditor must treat that person as a covered borrower notwithstanding a negative result from the MLA database.

Comments Due. Comments on the proposal are due November 28, 2014.

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