Department of Defense Military Lending Act

Summary of Amended Regulations (Final Rule)

CUNA MUTUAL GROUP

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In 2007, Congress passed the Military Lending Act (MLA), which was designed in part to address predatory lending practices with military members and their dependents. The Department of Defense (DoD) initially published regulations implementing the MLA that applied only to three types of consumer credit: (1) closed-end payday loans for less than 91 days and less than $2,000, (2) closed-end vehicle title loans with terms of 181 days or less, and (3) closed-end tax refund anticipation loans.

Among other requirements, a creditor cannot charge a military annual percentage rate (MAPR) that exceeds 36%. Importantly, the MAPR is broader than the annual percentage rate (APR) under Regulation Z because the MAPR includes costs that are not included in the APR. Based on the narrow scope of products originally covered, many credit unions were not impacted by the MLA.

On July 22, 2015, the DoD amended its regulations to expand the scope of credit transactions covered under the MLA and impose various additional obligations on credit unions (Final Rule). The Final Rule generally applies to all consumer credit transactions that are subject to Regulation Z, except: (1) credit that is expressly intended to finance the purchase of a motor vehicle or personal property, (2) residential mortgages, and (3) commercial transactions.

If the Final Rule applies to the credit transaction, a credit union will have to take several steps to ensure compliance, including:

- Determining whether the applicant(s) are protected by the Final Rule;
- Ensuring that the credit union does not charge a MAPR that exceeds 36%; and
- Providing required disclosures and complying with other lending limitations.

The DoD expanded the Final Rule to include new types of credit and to include in the MAPR fees/premiums for credit-related add-on products sold in connection with the credit transaction. However, nothing in the Final Rule prohibits the sale of payment protection products as long as the MAPR does not exceed 36%.

In addition to the Final Rule, the DoD provided guidance regarding the compliance requirements on August 26, 2016 (the August guidance) and on December 14, 2017 (the December guidance).

When do credit unions have to comply with the Final Rule?

While the Final Rule was effective on October 1, 2015, credit unions generally must comply with the Final Rule as of October 3, 2016, for all covered credit transactions except credit cards. For credit cards, compliance is required for accounts opened on or after October 3, 2017.

Which members are covered by the Final Rule?

The Final Rule covers members of the armed forces who are on active duty at the time credit is extended, and dependents of members of the armed forces who are on active duty at the time credit is extended.

The Final Rule provides two safe harbor methods for credit unions to determine if a member is covered by the Final Rule:

(1) the credit union relies on information from the DoD's database (https://mla.dmdc.osd.mil) or

(2) the credit union relies on information in a consumer report obtained from a nationwide consumer reporting agency meeting certain criteria.

The credit union must maintain appropriate records to receive the safe harbor.

Is my credit union required to ask all members if they are a military family and/or ask for documentation up front?

The Final Rule applies broadly to creditors, including a credit union that is engaged in the business of extending consumer credit. Thus credit unions should incorporate in their lending processes a method that will ensure compliance with the Final Rule. To do so, the Final Rule does not restrict a credit union's method of determining whether a member is a covered borrower; a credit union can create its own method. The safest way to ensure compliance is following one of the two safe harbor methods detailed in the Final Rule, in section 232.5(b).

Under the safe harbor, a credit union does not have to ask the borrower for any information relating to his or her covered borrower status. The credit union can rely upon information obtained from the DoD database or a nationwide consumer reporting agency or reseller.

This requirement is a one-time obligation for each specific transaction; there is no ongoing requirement to monitor whether the member becomes a covered borrower. However, credit unions must re-verify covered borrower status for each new loan or account.

What should my credit union be looking at on the report produced by a consumer reporting agency?

The Final Rule provides a safe harbor presumption of compliance if the creditor obtains the nationwide consumer reporting agency's report on the applicant, reviews the report for any status, code or indicator that the applicant is a covered borrower, and documents within its records that these steps were taken.

Does the Final Rule apply to all types of credit?

No. The Final Rule does not apply to credit secured by a dwelling, credit that is not covered by Regulation Z, or credit that is expressly intended to finance the purchase of a motor vehicle or personal property when the credit also is secured by the property being purchased.

Does the Final Rule apply to a credit transaction to purchase a vehicle if credit-related ancillary products are financed or there is "cash out" financing?

The DoD published an Interpretive Rule on February 28, 2020, rescinding previous guidance on credit transactions that also finance credit-related products, such as Guaranteed Asset Protection (GAP) and Credit Insurance. Various trade groups coordinated with the DoD to reach this result because their prior guidance had significant unintended negative consequences to military members, including the inability to purchase GAP and other valuable products. It appears the intent of the rescission is to revert back to prior interpretations of the MLA. Under these interpretations, loan for vehicles, or other personal property, secured by that property that also finance credit-related products are not covered loans under the MLA. While we believe this is the most accurate interpretation, the rescission of the prior guidance does not provide absolute certainty on how a regulator or other party may interpret the MLA in the future. To determine whether your credit union will treat these loan as covered loans, consider your credit union's risk appetite, current policies and procedures, and consult with your attorney.

In the same Rule, the DoD clarified that if a lender extends a hybrid purchase money and cash advance loan to a borrower (i.e. "cash out" financing), that transaction is not exempt, and the lender must treat the loan as a covered loan.

Does the Final Rule apply to a credit transaction to purchase a vehicle if negative equity is included in the loan amount?

No. In the December guidance, DoD confirmed that if a covered borrower trades in a motor vehicle with negative equity as part of the purchase of another motor vehicle, and the credit transaction to purchase the new vehicle includes financing to repay the credit on the trade-in vehicle, the entire credit transaction is eligible for the exception from MLA coverage. Rolling the negative equity into the loan expressly intended to purchase the motor vehicle is not considered "cash out" financing.

What is included in the MAPR?

The MAPR generally is calculated the same way as the APR (for closed-end credit) and the effective APR (for open-end credit) under Regulation Z, but the MAPR includes charges that would be excluded from the APR, such as credit insurance premiums, debt cancellation or suspension fees, fees for credit-related ancillary products, and certain application and participation fees. The MAPR contains detailed and complex exceptions for application fees and "bona fide" fees for credit card accounts.

Are CUNA Mutual Group's Credit Insurance, Debt Protection, Guaranteed Asset Protection and Mechanical Repair Coverage products included in the MAPR?

A credit union must initially determine what type of credit it is extending. If a credit union is extending credit covered by the Final Rule, the following will apply:

Credit Insurance, Debt Protection, and Guaranteed Asset Protection: The Final Rule clearly requires a credit union to include these in the MAPR.

Mechanical Repair Coverage: The Final Rule provides that the MAPR must include "any fee for a credit-related ancillary product sold in connection with the credit transaction." While the Final Rule does not specifically address Mechanical Repair Coverage nor define "credit-related ancillary product", the December 2017 guidance issued by DoD creates the impression that the cost of Mechanical Repair Coverage need not be included in the MAPR.

Does the MAPR impact a credit union's data processor and/or Loan Origination System?

A credit union's data processor and/or Loan Origination System will need to be able to calculate the MAPR. CUNA Mutual Group will be available to work with your credit union's system provider to answer questions they may have about the MAPR.

How does the Final Rule impact a firm offer of credit?

The Final Rule applies to credit transactions that are originated from a firm offer of credit. In order to receive safe harbor status for the covered borrower determination, a credit union must develop or process a firm offer of credit that (among the criteria used by the credit union for the offer) includes the status of the member as a covered borrower, according to information provided by the DoD database or a consumer report provided by a nationwide consumer reporting agency or reseller. The credit union may rely on this determination only if the member responds to the offer within 60 days. If the member responds to the offer more than 60 days after it was provided, then the credit union may not rely upon the initial covered borrower determination. Instead, the credit union must re-check to determine if the member is a covered borrower and protected by the Final Rule.

Which disclosures must a credit union provide?

The Final Rule requires a credit union to provide: (1) all disclosures required by Regulation Z; (2) a clear description of the member's payment obligation, and (3) the following general, written disclosure regarding the MAPR:

> 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 credit union is not required to provide the specific, numeric MAPR that applies to the transaction.

The credit union must provide the clear description of the payment obligation and the general disclosure regarding the MAPR both in writing and orally. The Final Rule allows the credit union to provide a toll-free phone number on the application form or in a written disclosure which a covered borrower may call to obtain the oral disclosures.

Does the toll-free phone number have to be dedicated to providing MLA oral disclosures?

No. The credit union may provide its general toll-free phone number on the application or disclosure statement and comply with the Military Lending Act oral disclosure requirement. The toll-free phone number is not required to be dedicated solely to MLA compliance.

Can a recording satisfy the oral disclosure requirements?

Yes, it is possible that a recording can satisfy the requirements to orally disclose the MAPR statement and the clear description of the member's payment obligation. In the August guidance, DoD stated that the requirement may be satisfied by a general description of how the payment obligation is calculated, or a description of what the borrower's payment obligation would be based on an estimate of the amount the borrower may borrow. For example, a credit union could generally describe how minimum payments are calculated on open-end credit plans issued by the credit union and then refer the borrower to the written materials the borrower will receive in connection with opening the plan.

May our credit union take a security interest in a covered borrower's shares?

Possibly. The July 2015 MLA final rule states that credit unions may take a security interest in funds deposited after the extension of credit into an account that was opened in connection with the extension of credit. In the August guidance, DOD discussed security interests in shares and the statutory lien on shares afforded under federal and several states' laws. DOD stated creditors are not prohibited from exercising a statutory right to take a security interest in funds, provided the security interest is not otherwise prohibited by applicable law and the creditor complies with the MLA regulation. In the December guidance, DOD stated that the final rule does not prohibit creditors from exercising rights to take a security interest in funds deposited into a covered borrower's account at any time, including enforcing statutory liens, provided the security interest is not otherwise prohibited by applicable law and the creditor complies with all other provisions of the MLA regulation.

Based on DOD's guidance, the LOANLINER® MLA-compliant documents have been updated to include reference to the statutory lien on members' share accounts, and to allow for a pledge of shares. When a member is in default, prior to exercising any collection rights the credit union must review their loan or credit account agreement with the member to determine what security interest and statutory lien rights exist. LOANLINER® and CUNA Mutual Group are unable to instruct credit unions on the specifics of exercising the statutory lien or acting on a covered borrower's pledge of shares.

If the MAPR exceeds 36% what are our options?

The preamble to the Final Rule states that for open-end credit, if the MAPR exceeds 36% for a given billing cycle, the credit union may choose to waive fees for that billing cycle to bring the MAPR below 36%. The rule does not provide other examples and does not specifically address closed-end credit. Several groups have requested additional guidance from DoD on this topic.

Do we have to provide the specific MAPR number to the member?

No, the final rule does not require the credit union to provide the covered borrower with the numeric Military Annual Percentage Rate that applies to the transaction. Instead, the model statement regarding the MAPR must be provided at or before the time the covered borrower becomes obligated on the transaction.

How is the Military Lending Act different from the Servicemembers Civil Relief Act?

The Military Lending Act and the Servicemembers Civil Relief Act are two separate laws with separate compliance requirements. The Military Lending Act applies to loans that are granted while the borrower is on active duty, or is a dependent of a person who is on active duty. In contrast, the Servicemembers Civil Relief Act applies to loans that were granted before the borrower entered active duty service. The two Acts also provide different protections to borrowers, and contain two entirely separate sets of compliance requirements.

What are the penalties for failing to comply?

Failing to comply with the MLA can lead to significant penalties including fines and imprisonment, the credit agreement, note, or other contract is void from inception, and civil liability including punitive damages and attorneys' fees.

What if I have more questions?

We understand your credit union may have additional questions over the coming months regarding the impact of the Final Rule. For questions, please contact us at dodmla@cunamutual.com.