Client Alert

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DOD Adopts Sweeping Changes to Rules Implementing Military Lending Act Provisions

By Leonard Chanin and Obrea Poindexter

On July 21, 2015, the Department of Defense (DOD) adopted sweeping changes to its rules that implement the Military Lending Act (MLA). The amended rules significantly expand the scope of the MLA provisions by covering both new types of creditors and new credit products, including credit cards. The new rule becomes effective on October 1, 2015, with compliance required by October 3, 2016. However, compliance with the rules for credit cards is delayed until October 3, 2017, unless extended for an additional year, until October 3, 2018.

There are many complexities, exceptions, special provisions and nuances associated with the final rule. This alert provides a high-level summary of the main provisions. A detailed analysis is forthcoming.

BACKGROUND

The MLA and DOD implementing rules apply to active duty service members and their spouses or dependents. Under existing DOD rules, the provisions apply to consumer credit, which is defined narrowly to include only "payday" loans, vehicle title loans and refund anticipation loans, as described in the regulation.

On September 29, 2014, DOD proposed extensive changes to its rules (79 *Fed. Reg.* 58,602 (Sept. 29, 2014)), including greatly expanding the scope of the restrictive coverage. DOD received more than 500 comment letters, including comments from industry, consumer groups, government agencies and other interested parties.

FINAL DOD RULE

Coverage

The final rule applies to creditors and any assignee of a creditor. Consumer credit is defined very broadly and covers any credit extended to a "covered borrower" for personal, family or household purposes that is subject to a finance charge or is payable by written agreement in more than four installments. Certain exceptions apply. Specifically, a loan or line of credit secured by a dwelling is exempt from coverage. In addition, a loan to finance the purchase of a motor vehicle, when the loan is secured by the vehicle, is exempt. Furthermore, a loan to finance the purchase of personal property, when the loan is secured by that property, is exempt.

The final rule applies to "covered borrowers," which is defined as a consumer who, at the time he or she is obligated on a credit transaction, is a service member who is on "active duty" or a spouse or dependent of such a person. The rule ceases to apply to a credit transaction (otherwise covered) if/when the consumer ceases to be on active duty. Creditors may use the DOD database or another method to determine whether a consumer is a "covered borrower." However, after October 3, 2016, a creditor may take advantage of a "safe harbor" in determining whether a consumer is a covered borrower only by using the DOD database or information from a

nationwide consumer reporting agency. It is not immediately clear how these sources will identify spouses and dependents.

The final rule, subject to special provisions, applies to both closed-end and open-end credit, including installment loans, lines of credit, credit cards and other consumer credit transactions. As noted above, loans secured by a dwelling, and certain financed loans secured by a motor vehicle or personal property, are exempt.

Requirements of the Rule

Similar to the proposed rule, the final rule only permits a creditor to impose a military annual percent rate (MAPR) of 36% or less for closed-end loans and for any billing cycle for open-end credit. Fees included in the MAPR are not limited to "finance charges" under Regulation Z, and include fees assessed in connection with the transaction or for credit-related products/services. Special rules apply to the calculation of the MAPR for open-end credit and for credit card accounts. Provisions in the final rule permit "bona fide" fees to be excluded from the MAPR for credit card accounts if creditors comply with detailed and quite complex provisions to qualify as "bona fide" fees.

Like the proposal, the final rule requires creditors to provide extensive disclosures to consumers in written and oral form. In addition, like the existing rule, the final rule prohibits creditors from requiring borrowers to submit disputes to arbitration and from imposing "onerous legal notice provisions" in the case of disputes.

There are significant risks related to noncompliance, including potential civil liability. In addition, the final rule provides that any credit agreement that fails to comply with the rules is "void from inception" of the contract.

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