

# Client Alert

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## A Closer Look at DOD's New Guidance on the Military Lending Act Regulations

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On August 26, 2016, the Department of Defense ("DOD") issued an interpretive rule (the "Interpretive Rule") providing guidance on the DOD's regulations implementing the Military Lending Act ("MLA"). That same day, we published a high-level summary of the Interpretive Rule, noting that the Interpretive Rule aims to clarify certain ambiguities in the DOD's July 2015 final rule. In this alert, we take a closer look at the Interpretive Rule, which is presented in a series of 19 questions and answers ("Q&As").

### BACKGROUND

The DOD first finalized rules to implement the MLA in August 2007 (the "2007 Rules"). Under the 2007 Rules, the MLA covered only three types of loans: payday loans, vehicle title loans, and refund anticipation loans. In September 2014, the DOD proposed to vastly expand the scope of the rules to cover new types of creditors and credit products. The DOD finalized its new MLA rules in July 2015 (the "2015 Rules") largely as proposed. Under the 2015 Rules, the MLA applies to most non-mortgage closed-end and open-end credit, including installment loans, student loans, single-payment loans, lines of credit, and credit cards.

The 2015 Rules raised a number of operational and legal issues. In April 2016, Morrison & Foerster joined major financial services trade associations in urging the DOD to issue an interim final rule to resolve critical ambiguities in the 2015 Rules.

In lieu of an interim final rule, the DOD issued an Interpretive Rule, which provides guidance on the 2015 Rules. The Interpretive Rule does not address all of the operational and compliance issues raised by the 2015 Rules. It does, however, provide much needed clarity on several issues that are critical to creditors' compliance with the MLA.

The Interpretive Rule does not change the date by which creditors must comply with the 2015 Rules. Generally, creditors must comply by October 3, 2016. Compliance for credit cards is delayed until October 3, 2017, unless extended for an additional year until October 3, 2018. Additionally, the Interpretive Rule, which was effective immediately upon publication in the *Federal Register* on August 26, 2016, is not subject to public comment.

### CLARIFICATIONS UNDER THE INTERPRETIVE RULE

As noted above, the Interpretive Rule is comprised of 19 questions and answers. Several Q&As address important operational or compliance issues.

- **Payments by check and electronic fund transfer are permitted.**

Section 232.8 makes an extension of credit unlawful if, in connection with the extension of credit, the creditor "uses a check or other method of access to a deposit, savings, or other financial account" maintained by a covered borrower. As drafted, this provision could be read to prevent creditors from accepting payment from covered borrowers by check and electronic fund transfers.

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At Q&A No. 16, the Interpretive Rule clarifies that section 232.8(e) prohibits creditors from creating remotely-created checks and/or using post-dated checks provided by the borrower at or around the time credit is extended. According to the Interpretive Rule, section 232.8(e) does not prohibit creditors from accepting payment from covered borrowers by check or using electronic fund transfers (“EFTs”), including preauthorized EFTs.

- **When providing oral or written disclosure of a payment obligation, a general description is sufficient.**

Section 232.6(a)(3) requires a creditor to provide a covered borrower with a clear description of the payment obligation before or at the time the covered borrower becomes obligated on the transaction or establishes an account. Section 232.6(d) requires these disclosures to be made orally and in writing. With respect to oral disclosures, the required disclosures may be delivered in person or via a toll-free telephone number. At Q&A 12, the Interpretive Rule clarifies that creditors may provide a general description of how the payment obligation is calculated, for both the oral and written disclosures, as long as that description is clear and accurate. The payment obligation disclosure need not reflect the specific terms of a credit agreement or credit transaction or include the level of detail required by Regulation Z for written disclosures given at consummation or at account-opening.

- **Creditors need not draft special credit agreements for covered borrowers. A standard credit agreement with a savings clause is permitted.**

Sections 232.8 and 232.9 bar a creditor from including certain proscribed terms and provisions (e.g., a mandatory arbitration provision) in a credit agreement with a covered borrower, and they provide that a credit agreement containing one or more proscribed terms and provisions is void.

At Q&A No. 15, the Interpretive Rule clarifies that a creditor need not draft special credit agreements for covered borrowers. According to the Interpretive Rule, creditors may include a proscribed term or provision (e.g., a mandatory arbitration clause) in a standard credit agreement, and they may use the standard agreement for covered borrowers and non-covered borrowers alike, provided that the standard agreement contains a savings clause limiting application of the proscribed terms or provisions to non-covered borrowers.

- **In a “no balance” billing cycle, a creditor may impose fees or charges that are excluded from the calculation of the military annual percentage rate (“MAPR”).**

Section 232.4(c)(2)(ii)(B) provides that for open-end credit, if the MAPR cannot be calculated in a billing cycle because there is “no balance” in the cycle, a creditor may not impose “any fee or charge”, except for certain participation fees (e.g., an annual membership fee). As drafted, this provision could be read to prohibit creditors from charging any fee or charge, including those excluded from the MAPR calculation (e.g., late fees or bona fide and reasonable credit card fees), any time that there is “no balance” in a billing cycle on an open-end account.

At Q&A No. 5, the Interpretive Rule clarifies that, in a “no balance” billing cycle, a creditor may impose fees or charges that are excluded from the calculation of the MAPR. If a creditor only imposes fees or charges that are excluded from the MAPR calculation (e.g., late fees or bona fide and reasonable credit card fees), the “no balance” rule does not apply.

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Several other Q&As provide helpful guidance on ambiguous provisions in the Rules.

- **An assignee may avail itself of the covered borrower identification safe harbor as long as the assignee maintains the original creditor's record of the covered borrower identification check.**

Under Section 232.5(b), creditors are permitted to determine whether a consumer is a covered borrower under the MLA if the creditor checks the identification of the consumer in accordance with Section 232.5(b)(2). Section 232.5(b)(3) makes clear that the creditor has a safe harbor with respect to a covered borrower identification check completed in conformance with Section 232.5(b)(3) as long as the creditor creates and maintains a record of the covered borrower identification check. At Q&A No. 9, the Interpretive Rule clarifies that the safe harbor extends to a creditor's assignee, provided that the assignee continues to maintain the record of the covered borrower identification check created by the original creditor.

- **Creditors may consider benefits offered by credit card rewards in determining whether a fee is reasonable.**

Creditors may exclude bona fide and reasonable credit card fees from the MAPR. Under Section 232.4(d)(3)(i), whether a fee is reasonable is determined by comparing the fee to fees typically imposed by other creditors for the same or a substantially similar product. At Q&A No. 8, the Interpretive Rule clarifies that creditors may use any reasonable approach in identifying whether a fee is substantially similar for purposes of comparison and reasonable overall. According to the Interpretive Rule, it would be a reasonable approach to consider benefits provided by a rewards program in determining what other products to compare the fee against and in determining whether a fee is reasonable overall.

- **Disclosures required under the MLA Rule may be provided at the time prescribed by Regulation Z.**

Q&A No. 14 clarifies the requirement in Section 232.6(a) that any disclosure required under the MLA Rule, including Regulation Z disclosures, may be provided in accordance with the requirements of Regulation Z. Thus, creditors may use the timing provisions in Regulation Z, for example, for credit requested by telephone.

- **A hybrid purchase money and cash advance loan secured by personal property is not excluded from coverage.**

The MLA generally applies to extensions of "consumer credit." Among the exceptions to the definition of "consumer credit" is "any credit transaction that is expressly intended to finance the purchase of personal property [or a motor vehicle] when the credit is secured by the property [or vehicle] being purchased."

At Q&A No. 2, the Interpretive Rule provides that a hybrid purchase money and cash advance loan that is both secured by personal property and used to purchase the property is not expressly intended to finance the purchase of personal property (i.e., the cash-out portion of the loan has another purpose), and, thus, the transaction is not exempt "because the loan provides additional financing that is unrelated to the purchase." However, the Q&A also states that, to be exempt, a loan must finance only the acquisition of the personal property.

Notably, Q&A No. 2 does not expressly address the parallel exception for the purchase of a motor vehicle. However, the language of the two exemptions in the Regulation is identical; thus, the analysis used to evaluate a loan to purchase a motor vehicle should be identical to the analysis used to examine a loan to purchase personal

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property. On balance, while the Interpretive Rule is not perfectly clear, in light of the regulatory text, it appears that the exemption should apply if a transaction involves an extension of credit to purchase a vehicle (or personal property) even if the loan finances related costs, such as fees for title and tags for a vehicle loan and taxes, provided the creditor does not provide any “cash out” to the consumer.

In addition to the clarifications discussed above, the Interpretive Rule includes guidance on several other issues.

- The MLA Rule covers only those overdraft products that are “credit” under Regulation Z. Accordingly, discretionary overdraft services should not be covered.
- Creditors may take a security interest in a consumer’s checking or other financial account, as permitted by the MLA Rule.
- Creditors may periodically screen credit portfolios for changes to covered borrower status.
- For purposes of the safe harbor for reasonable and bona fide credit card fees, creditors may rely on commercially compiled sources of information to conduct the necessary calculations.
- Creditors may waive fees to avoid exceeding the MAPR ceiling.
- A minimum interest charge may be eligible to be excluded from MAPR as a bona fide and reasonable credit card fee.

While the Interpretive Rule offers important guidance to creditors preparing for the pending compliance deadlines, operational and other issues remain, particularly for credit card issuers. We will continue to communicate with the DOD about these issues and provide additional updates as appropriate.

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