

# Overview of Financial Protections for Military Service Members

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The U.S. Department of Defense (“DOD”) has put into effect the newly amended Military Lending Act (“MLA”) rule, which applies the protections of the MLA’s strict lending restrictions to consumer credit card issuers and unsecured consumer lenders—including depository institutions that have never before been subject to the MLA. Compliance with the new rule is required beginning October 3, 2016.

While depository institutions have been working over the past several years to build Servicemembers Civil Relief Act (“SCRA”) compliance programs, the revised MLA rule means that these institutions must now comply with an entirely new set of legal requirements for military service member-borrowers. Among other protections, the MLA caps the Military Annual Percentage Rate (“MAPR”) on covered transactions to active military service members at thirty-six (36%) percent. The MLA also requires certain disclosures to be provided service members and their dependents and prohibits creditors from requiring arbitration in the event of a dispute. The penalties for a violation will be severe—damages of not less than \$500 per violation, plus punitive damages and attorneys’ fees.

This advisory will discuss the newly amended MLA, the SCRA, and a New York State law that also provides protections for military service members and their families.

## The New MLA

The amendments extend the types of closed-end and open-end consumer credit products covered under the MLA to include those aligned with the definition of “consumer credit” under the Truth in Lending Act and Regulation Z. Under the new rule, MLA protections apply to any credit offered or extended to a covered borrower primarily for personal, family, or household purposes, and that is (i) subject to a finance charge or (ii) payable by a written agreement in more than four installments.

As a result of the expanded definition of “consumer credit,” the new MLA applies to all forms of vehicle title loans, installment loans, unsecured open-end lines of credit, payday loans, refund anticipation loans, credit cards, deposit advance loans and overdraft lines of credit (but excludes demand deposit account overdraft protection services). According to the DOD, these substantial changes are intended to address short-term, small-dollar lenders who have previously avoided MLA compliance by offering slightly modified loan terms that fall outside the scope of the MLA’s coverage. The MLA still exempts residential mortgages and purchase-money vehicle-secured loans.

If a product is covered by the MLA, the institution must also verify whether the consumer is a “covered borrower” at the time the consumer becomes obligated on a consumer credit transaction or establishes an account for consumer credit. The MLA defines “covered borrower” as a “covered member” or a dependent of a “covered member.” A “covered member” is a member of the armed forces who is serving on (1) active duty as a member of the U.S. military, Coast Guard, or National Guard, under a call or order that does not specify a period of thirty (30) days or fewer, or (2) Active Guard and Reserve duty. Institutions are responsible for determining an applicant’s military status and must inquire “directly or indirectly” with the DOD’s database or a nationwide consumer reporting agency that provides such information. MLA restrictions only apply to accounts opened while the borrower is eligible for MLA protection, and the protections terminate upon ineligibility.

Under the MLA, covered credit transactions are capped at a thirty-six (36%) percent MAPR. For closed-end credit, the MAPR has generally calculated the same way as an Annual Percentage Rate (“APR”) is calculated under Regulation Z, but it also includes the following fees and charges, even if they would not be considered finance charges under Regulation Z:

1. Credit insurance premiums and fees for debt cancellation or debt suspension agreements;
2. Fees for credit-related ancillary products sold in connection with the credit transaction or account;
3. Finance charges associated with the consumer credit; and
4. Certain application fees and participation fees, including annual fees.

The MAPR for open-end credit must also be calculated using the same basic formula as prescribed in Regulation Z and must include the above fees and charges. If there is no balance in a billing cycle, a creditor may not charge any fee except for a participation fee, which cannot exceed \$100 per year (regardless of the billing cycle in which the fee is imposed).

The MLA regulations allow a creditor to exclude from the MAPR a bona fide fee—other than a periodic rate—only to the extent that the charge by the creditor is (i) a “bona fide” fee and (ii) “reasonable” for that type of fee. The DOD believes that these conditions for excluding a bona fide fee from the MAPR allow service members and their families to continue to have access to credit card products and limit the opportunity for a creditor to exploit the exclusion for those products. The exclusion is designed to bar a creditor from transforming high-cost, open-end credit products into credit card accounts by offering a relatively lower periodic rate coupled with a high application fee, participation fee, or other fees.

The new rule also requires a creditor to provide: (i) a “statement of the MAPR” applicable to the extension of consumer credit, (ii) any disclosures required by Regulation Z, and (iii) a clear description of the payment obligation of the covered borrower. In addition, the rule prohibits creditors from requiring service members and their dependents to submit to arbitration or waive their rights under the SCRA (discussed below) or imposing onerous legal notice requirements in the case of a dispute.

## Operation in Conjunction with the Servicemembers Civil Relief Act

The MLA will operate in conjunction with the SCRA. The SCRA was enacted in 2003 to provide protection for individuals entering military service.

Although the SCRA and the MLA both apply to military service members, they apply to different classes of such individuals. The SCRA provides an interest rate benefit, found in section 3937 thereof, which only applies where the individual was not on military service at the time of origination. In contrast, the MLA only applies where the individual was on qualifying military service at the time of origination. Thus, the MLA neither affects the applicability of section 3937 nor any other provision of the SCRA.

Under the SCRA, when an obligation was incurred before entry on active duty, the interest rate may not exceed 6% upon entry on active duty, unless the creditor can prove in court that the service member's ability to pay was not materially affected by military service. The term "interest" includes service charges. Interest in excess of 6% per year on pre-service loans and obligations must be forgiven. The service member must request the interest reduction in writing with a copy of his or her military orders. Upon receiving notice, a creditor must grant relief effective as of the date the service member is called to active duty.

Additionally, the SCRA protects service members against foreclosures of mortgages, deeds of trust, and similar security devices, provided all the following conditions are met:

1. The relief is sought on an obligation secured by a mortgage, deed of trust, or similar security on either real or personal property;
2. The obligation originated prior to entry upon active duty;
3. The property was owned by the service member or dependent before entry on active duty status;
4. The property is still owned by the service member or dependent at the time relief is sought;
5. The ability to meet the financial obligation is "materially affected" by the service member's active duty obligation; and
6. The action is filed during, or within 90 days after, the service member's period of military service.

## New York State Soldiers' and Sailors' Civil Relief Act and Preemption

New York State law also provides rights and protections for current and recently-separated military service members and their families in matters related to debt, foreclosure, insurance, leases, and other contracts under the New York State Soldiers' and Sailors' Civil Relief Act ("NY SSCRA").

Similar to the SCRA interest cap, Section 323-a of the NY SSCRA caps interest on obligations or liabilities incurred before service at 6% during the period in which the individual is an active military service member unless the service member's ability to pay is not materially affected by service.

Unlike the MLA, which pertains only to consumer credit transactions, the NY SSCRA, like the federal SCRA, makes special provision for obligations secured by mortgages, trust deeds, and similar securities against real property owned by persons in military service where the credit obligations originated prior to military service. In addition, among other things, the NY SSCRA: (i) describes the circumstances under which a court may stay proceedings or

make such other disposition as may be equitable; (ii) declares that no sale or foreclosure is valid if made within the period of military service or within six months thereafter, unless upon an order of sale previously granted by the court; and (iii) makes provision with regard to the settlement of cases involving stayed proceedings in mortgage foreclosure.

If a direct conflict exists between the NY SSCRA and its federal counterpart—the SCRA—SCRA protections control. Likewise, if a state law conflicts with a provision of the MLA, the MLA will also prevail under MLA section 232.7. However, state law is not preempted if it provides protection to a covered borrower greater than those protections provided the MLA. Further, MLA section 232.7 prohibits a state from: (1) authorizing creditors to charge covered borrowers rates of interest for any consumer credit or loans higher than the legal limit for residents of the state and (2) permitting the violation or waiver of any state consumer lending protection covering consumer credit that is for the benefit of residents of the state on the basis of the covered borrower's nonresident or military status, regardless of the covered borrower's domicile or permanent home of record, provided that the protection would otherwise apply to the covered borrower.

Please note that this is a general overview of the MLA, SCRA and NY SSCRA, and this advisory is not intended as legal advice. If you have any questions regarding the applicability of any rules pertaining to financial protections for military service members, please feel free to contact Joseph D. Simon at [516-357-3710](tel:516-357-3710) or via email at [jsimon@cullenanddykman.com](mailto:jsimon@cullenanddykman.com), Kevin Patterson at [516-296-9196](tel:516-296-9196) or via email at [kpatterson@cullenanddykman.com](mailto:kpatterson@cullenanddykman.com), or Adam Barazani at [516-357-3767](tel:516-357-3767) or via email [abarazani@cullenanddykman.com](mailto:abarazani@cullenanddykman.com).

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