

The Military Lending Act

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1. Recognizing that troops are often targeted by commercial predators, and that such predation adversely affects not only individual victims, but also the national defense, Congress passed and President George W. Bush signed into law the Military Lending Act (10 USC 987). The MLA, enacted in 2006, attempts to prevent victimization of troops and their families by (a) requiring covered lenders to determine whether the prospective borrower is a service member or dependent, (b) limiting the interest that can be charged in covered loans to 36% annual percentage rate, and (c) prohibiting lenders from engaging in certain practices with respect to covered loans.

2. *Secretary of Defense Authority.* The MLA gave the Secretary of Defense broad authority to make regulations determining which loans will be covered, what disclosures must be made, and how interest is to be calculated. The law specifically exempts residential mortgages, as well as loans made to purchase personal property where the loan is secured by that property, for example, the typical auto finance loan.

3. *Implementing Regulation.* In the original (and current) implementing regulation (32 CFR 232) the Secretary of Defense used its authority very cautiously and sparingly, promulgating a regulation that severely limits the scope of the MLA's coverage. As currently implemented, the MLA covers only the following types of loans: payday loans, car title loans, and refund anticipation loans. Notably, the Regulation does not cover installment loans, often a high interest, short-term loan payable in installments. These loans are often heavily marketed toward troops and are available on line or at brick and mortar stores near major military installations. The current Regulation also does not cover credit card transactions. Further, even the loans that are covered are defined in a very restrictive way. Predictably, these limitations and loopholes have been exploited by some to continue to gouge troops with triple digit interest rates. As a result, the Department of Defense has proposed a far more expansive regulation which may be effective in the foreseeable future.

4. Under the current Regulation, only some payday loans, refund anticipation loans, and car title loans are covered.

a. *Payday Loan.*

(1) Historically, the payday loan has been marketed to troops as a means of providing quick cash for emergencies. The loan period was often two weeks or less, the time until the next military paycheck. Often, payday lenders would take a check from the borrower in the amount of the loan, and promise not to present the check for payment until payday. Annual interest rates were typically in the range of about 360% or more. For example, a payday lender might charge \$45 (15% of the loaned amount) for a two week, \$300 loan. As an annual percentage rate of interest, the rate of such a loan is 390%. If, as is so often the case, the

borrower is unable to repay the loan, the payday lender would offer yet another loan, and another, and so on, in a cycle of debt and borrowing.

(2) The Regulation defines a payday loan as closed ended credit with a term of 91 days or fewer in which the amount financed does not exceed \$2,000, and the borrower is charged a fee or interest and either (a) provides a check or other payment instrument to a creditor who agrees to delay presentment of the instrument for payment for a day or longer, or (b) authorizes the creditor to debit the borrower's account after a day or more.

b. *Vehicle Title Loan.* A car title loan is not the typical loan used to purchase a vehicle. Instead, the borrower already owns a vehicle and pledges it as security to obtain a high interest, short term loan. Like the payday loan, the interest is usually exorbitant and the likelihood of falling into a debt trap is high, but in addition, the borrower also risks forfeiture of his car. The Regulation defines a vehicle title loan as close ended credit of 181 days or less, secured by title to a motor vehicle. It does not include credit offered to purchase a car secured thereby.

c. *Tax Refund Anticipation Loans.* In the refund anticipation loan (RAL), the tax preparer provides the borrower with cash in the amount of the anticipated refund. The funds are provided immediately or, at least somewhat sooner than the taxpayer would expect to receive a refund check from the Internal Revenue Service. For those who file electronically, the IRS provides refunds via direct deposit within seven to fourteen days. Thus, the scheme amounts to a very short term loan. If the tax preparer charges, say, 10% of the anticipated refund as his fee, then the interest, figured on an annual basis, is at least 260%. The Regulation defines a RAL as close ended credit in which the borrower gives the creditor the right to receive all or part of the tax refund or agrees to repay the loan with the refund. Tax preparers have responded with schemes in which, for an additional charge, the payment of tax preparation fees is deferred until the taxpayer receives a refund.

5. *Identification of Covered Borrower.* The MLA imposes restrictions on covered loans when sold to a covered borrower. Accordingly, the creditor is required to take steps to determine whether the borrower is a member of the armed forces or a dependent. Specifically, lenders offering any of the products identified in paragraph 4 above are required to clearly and conspicuously provide the following or substantially similar statement to all prospective borrowers:

Federal law provides important protections to active duty members of the Armed Forces and their dependents. To ensure that these protections are provided to eligible applicants, we require you to sign one of the following statements as applicable:

I AM a regular or reserve member of the Army, Navy, Marine Corps, Air Force, or Coast Guard, serving on active duty under a call or order that does not specify a period of 30 days or fewer.

I AM a dependent of a member of the Armed Forces on active duty as described above, because I am the member's spouse, child under the age of eighteen years old, or I am an individual for whom the member provided more than half of my financial support for 180 days immediately preceding today's date.

--OR--

I AM NOT a regular or reserve member of the Army, Navy, Marine Corps, Air Force, or Coast Guard, serving on active duty under a call or order that does not specify a period of 30 days or fewer (or a dependent of such a member).

Warning: It is important to fill out this form accurately. Knowingly making a false statement on a credit application is a crime.

Additionally, the creditor may, but is not required to, verify the borrower's military status by requesting a current military leave and earnings statement (LES) or armed forces identification card for service members. The creditor may also verify military status by using information posted on line by the Defense Manpower Data Center at <http://www.dmdc.osd.mil/mla/owa/home> Inputting name and social security number (or birthdate) of the prospective borrower will quickly yield a response indicating whether the person is a member of the armed forces.

6. *Interest Rate Limitations.* If the transaction type is covered by the MLA, the creditor may still sell the product to a service member or dependent; however, there are certain limitations, the most important of which is the interest rate. The maximum Military Annual Percentage Rate (MAPR) on covered transactions is 36%. As a practical matter, payday loans, RALs and vehicle title loans virtually always exceed an APR of 36%; any such loan could therefore not be made to a service member or dependent thereof.

7. *Military Annual Percentage Rate.* In calculating the MAPR, the following cost elements must be included: interest, fees, credit service charges, and credit renewal charges (charges to renew an existing loan). Additionally, the MAPR includes credit insurance premiums, fees for debt cancellation or suspension, and fees for other products sold in connection with and at or before the credit transaction. The regulation was written in this manner to prevent lenders from extending credit that nominally complies with the MLA interest limitations but which is nonetheless extremely costly due to the various added fees and charges. Nothing is gained by a regulation that induces creditors to make loans that are just as costly as before, but which shifts the cost elements from interest to add on fees. Additionally, the MAPR calculation helps prevent covered loans from being larded up with costly add-ons of little value to the consumer. The MAPR does not include late fees, or taxes / fees that creditors must pay to public officials in connection with a recording a security interest. The tax preparation fee associated with a RAL is also not included in the MAPR.

8. *Other Limitations on Covered Credit Transactions.*

-Creditors cannot extend or refinance a covered transaction unless the terms, such as interest rate, are more favorable to the consumer than the original terms;

-Borrowers cannot be required to waive rights under the Servicemember Civil Relief Act, or other federal or state rights, as a condition of obtaining credit;

-The creditor cannot demand unreasonable notice from the borrower as a condition for legal action;

-Creditors may not use a check or other means to access the borrower's financial account, except that (a) Electronic Funds Transfer may be used to repay a loan if not otherwise prohibited by Regulation E (12 CFR 205) or other federal or state regulation; (b) the creditor may require direct deposit of the borrower's salary if not otherwise prohibited; and (c) the creditor may take a security interest in the borrower's deposited funds if not otherwise prohibited;

-Creditors may not require payment via allotment as a condition of extending credit.

-Creditors cannot prohibit prepayment or charge a prepayment penalty;

-Assignees may not engage in any conduct that would be prohibited for the creditor; and

-Any agreement to arbitrate a dispute concerning a covered transaction may not be enforced against a consumer; i.e., mandatory arbitration is prohibited.

9. *Relationship to State Law.* State law may enlarge consumer rights, but any diminishment of MLA rights under state law is prohibited.

10. *Enforcement.* Any contract made in violation of the MLA is void. In addition, the aggrieved plaintiff may obtain equitable or declaratory relief, and may recover compensatory damages in an amount of not less than \$500 per violation, as well as punitive damages. The losing defendant is liable for payment of court costs and the plaintiff's attorney fees. In addition, the plaintiff may avail himself of "any other relief provided by law" including consequential damages. The creditor's knowing violation of the MLA is a misdemeanor punishable by a fine and up to one year imprisonment. The creditor may escape civil liability by showing by a preponderance of the evidence that the violation was unintentional, and resulted from an error notwithstanding procedures reasonably adapted to prevent such errors. An error in legal judgment, however, is not a defense.

11. *Agency Enforcement.* Several federal agencies are empowered to enforce the MLA, including the Federal Trade Commission, the Board of Governors of the Federal Reserve, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Consumer Finance Protection Bureau (CFPB), the National Credit Union Administration, and the U.S. Treasury. Aggrieved consumers should file an online complaint with the CFPB, which may investigate individual complaints and which has taken enforcement action under the MLA. For example, the CFPB took action against Cash America, alleging that the defendant overcharged service members, robo-signed debt collection pleadings and other court papers without reasonable prior review for accuracy, and impeded the CFPB's investigation. The resulting consent order (2013-CFPB-0008 of November 20, 2013) directed Cash America to provide refunds of up to \$14 million, pay a \$5 million fine, dismiss pending debt collection lawsuits, and correct adverse credit information of 14,000 persons.

12. *Rulemaking.*

a. From the outset, there was concern that the implementing regulation was too narrowly drafted. In fact, the Judge Advocates General of each of the armed forces co-signed a letter to that effect. Although the MLA had a positive effect in eliminating some predatory products, others in the industry continued to lend money to service members and their dependents at extraordinarily high interest rates, skirting the MLA by making the loans ostensibly open ended, or structuring them such that the loan period or amount borrowed fell just outside the parameters of MLA. Installment loans continued unabated at rates well in excess of 36% APR.

b. On June 17, 2013, the Department of Defense published Advance Notice of Proposed Rulemaking (ANPR) soliciting comments concerning the need to amend the MLA Regulation. In April 2014, the Department of Defense released its report “Enhancement of Consumer Credit for Members of the Armed Forces and their Dependents,” addressing whether changes to the MLA implementing instruction were in order. Without providing a specific proposed rule, the report concluded that a more comprehensive approach was in fact needed. On September 29, 2014, the Department of Defense published a specific proposed rule in the Federal Register (Fed Reg # 2014-22900, Docket # DOD-2013-0D-133-0039) for public comment. The public comment period has closed and the Department is not considering whether to promulgate its proposed rule and, if so, whether it should be amended.

c. The proposed rule as written will cover all credit extended to a borrower primarily for personal, family, or household purposes and which (a) is subject to a finance charge or (b) is payable by written agreement in four or more installments. The Rule will therefore apply to all of the loan products addressed by its predecessor and, in addition, such products as installment loans, credit cards, and other open ended credit. A MAPR of 36% is to be applied, with particularly detailed instructions concerning what fees a credit card issuer may charge. Rent to Own transactions, mortgages, and credit extended to purchase personal property that is secured by that personal property would not be covered under the proposed Rule.

13. *Summary.* The MLA designed to be a bulwark against predatory lending practices directed at service members and their dependents. It limits interest on covered transactions to 36% and prohibits various other onerous contractual provisions. Military legal assistance attorneys, financial counsellors, and others advising service members and their dependents should be familiar with this statute and the various means of enforcing it. The MLA can assist in resolving issues of individual clients and may also result in federal agency enforcement action on behalf of a large number of claimants. The MLA implementing regulation currently limits its application to a relatively small subset of loans, but may soon be expanded to cover a far larger universe of credit transactions.