

Financial Institutions Webinar: The New Military Lending Act (MLA) Regulations Compliance Risks and Challenges

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Agenda

- MLA Background
- New MLA Requirements
- Determining Borrower Eligibility
- Calculating the Military APR (MAPR)
- Penalties for Non-Compliance
- Relationship to SCRA
- Current Compliance Environment
- Recommendations and Best Practices



MLA Background

- In 2007, the DOD published the first regulations implementing the MLA and defined three narrow bands of products as “consumer credit” subject to the Act’s requirements.
 - closed-end payday loans for no more than \$2,000 and with a term of 91 days or fewer;
 - closed-end auto title loans with a term of 181 days or fewer; and
 - closed-end tax refund anticipation loans.
- In September 2014, the DOD published a proposed rule that would extend its regulations to cover a broader range of closed-end and open-end credit products. 79 Fed. Reg. 58602 (Sept. 29, 2014).
- In July 2015, the DOD published a final version of the revised MLA regulations. These regulations extend the MLA to cover credit products issued and serviced by many banks and credit unions, most notably credit cards and private student loans. 80 Fed. Reg. 43560 (July 22, 2015).



MLA Requirements Overview

- **Covered Products Test:** In the revised regulations, the DOD has redefined “consumer credit” to cover the same products covered by the Truth in Lending Act (TILA).
 - TILA, which is implemented by Regulation Z, covers any “credit offered or extended to a covered borrower primarily for personal, family, or household purposes, and that is subject to a finance charge or payable by a written agreement in more than four installments.” 12 C.F.R. § 1026.1(c)(1)(iii).
 - The DOD adopted the same definition such that “consumer credit covered under the MLA would be defined consistently with credit that for decades has been subject to the disclosure requirements of [TILA].” 80 Fed. Reg. 43560 (July 22, 2015).



MLA Requirements Overview, con't.

- **Covered Products:** Under the new test, the MLA applies to many products issued and serviced by banks and credit unions, including:
 - credit cards;
 - unsecured open-end lines of credit;
 - automotive refinance loans;
 - some loans on unimproved property (lot loans);
 - private student loans; and
 - overdraft lines of credit.

- **Products Not Covered:** The MLA specifically excludes certain credit products, and it does not apply to any credit transaction that is exempt or not subject to disclosure requirements under TILA, including:
 - residential mortgages secured by a dwelling;
 - federal student loans (Title IV);
 - business, commercial, or agricultural purpose credit;
 - most automobile loans; and
 - traditional demand deposit account overdraft protections services.



MLA Requirements Overview, con't.

- **Covered Borrowers:** MLA protections apply to servicemembers, or their dependents, who open an account while on qualifying military service. 32 C.F.R. § 232.2(a).
 - Servicemembers who are serving on active duty under Titles 10, 14, or 32 of the U.S. Code for a period of at least 31 days.
 - Servicemembers who are serving on active guard and reserve duty as defined in 10 U.S.C. § 101(d)(6).
 - Dependents of the above eligible servicemembers, including spouses, unremarried widows, children, dependent parents, and other financial dependents. 10 U.S.C. § 1072(2).

- **Termination:** MLA protections terminate when the servicemember leaves qualifying military service. 32 C.F.R. § 232.3(g).



MLA Requirements Overview, con't.

- **Key Protections:** The MLA affords three key protections to covered borrowers engaged in transactions involving covered products:
 - **Maximum Rate:** Covered borrowers cannot be charged more than a 36% Military Annual Percentage Rate (MAPR).
 - **Disclosures:** Covered borrowers must receive certain oral and written disclosures, including a statement of the applicable MAPR and a clear description of the payment obligation.
 - **Prohibited Terms:** Covered borrowers cannot be required to submit to certain contract terms, such as mandatory arbitration or a penalty when pre-paying a loan.



MLA Requirements Overview, con't.

- **Mandatory Disclosures**: The MLA requires a creditor to provide three categories of information to a covered borrower “at the time the borrower becomes obligated on the transaction or establishes an account for the consumer credit.” 32 C.F.R. § 232.6(a); see *also* 10 U.S.C. § 987(c).
 1. A statement of the MAPR applicable to the extension of credit;
 2. Any disclosure required by Regulation Z; and
 3. A clear description of the payment obligation of the covered borrower, which can be satisfied by a payment schedule (in the case of closed-end credit) or account-opening disclosure (in the case of open-end credit).



MLA Requirements Overview, con't.

- **Mandatory Disclosures (con't.):**
 - **Statement of MAPR:** The MAPR statement does not need to be a statement of the actual interest rate assessed on the loan. Rather, the requirement is met by providing a statement of the maximum MAPR that may be assessed under law. The MLA regulations provide a model statement that can be used to satisfy the statement of MAPR requirement. 32 C.F.R. § 232.6(c)(3).
 - **Disclosure Methods (written/oral):** The disclosures must be provided in writing, in a form the borrower can keep, and orally. The oral disclosures may be provided to the borrower in person or by a toll-free telephone number.
 - **Refinance or renewal:** New MLA disclosures must be provided in the refinance or renewal of a loan if the agreement would be a new transaction requiring disclosure under Regulation Z.



MLA Requirements Overview, con't.

- **Prohibited Contract Terms:** The MLA prohibits creditors from extending “consumer credit” to “covered borrowers” under certain terms. See 32 C.F.R. § 232.8.
 - No rollovers, renewals, refinancing, or consolidation (applies to deferred presentment/payday loans only).
 - No mandatory waivers of right to legal recourse, including the SCRA.
 - Cannot require unreasonable notice as a condition for legal action.
 - Cannot require a borrower to submit to arbitration, or impose other “onerous legal notice provisions.”
 - Cannot require mandatory allotments to repay obligation.
 - No prohibitions on prepaying and no charging a prepayment penalty.
 - No use of checks or other methods of access to deposit, savings, or other accounts in certain circumstances.
 - No use of a vehicle as security for obligation (not applicable to chartered banks, savings associations, or credit unions).



MLA Requirements Overview, con't.

- **Effective Date**: The new MLA regulations became effective on October 1, 2015.
- **Compliance Required**: Compliance with the MLA regulations is required by October 3, 2016.
- **Credit Card Compliance**: The date for compliance for credit cards is delayed an additional year until October 3, 2017 (or later).



Deep Dive – Determining MLA Eligibility

- **Safe Harbor**: Under the new regulations, creditors are granted a “safe harbor” for compliance if they use either or both of two methods to determine whether a consumer is a “covered borrower” for purposes of the MLA’s protections:
 1. **MLA Database**: Verify the status of the consumer on the Department of Defense Manpower Data Center (commonly known as the “MLA Database”). See 32 C.F.R. § 232.5(b)(2)(i).
 2. **Credit Report**: Use a consumer credit report from a nationwide reporting agency that contains military status. See 32 C.F.R. § 232.5(b)(2)(ii).
- **No clawback** of safe harbor due to information in lender file indicating MLA eligibility (clawback was included in proposed rule). 79 Fed. Reg. 58639 (Sept. 29, 2014).



Deep Dive – Determining MLA Eligibility, con't.

- **Covered Borrower Search Timing:** A creditor is only required to check the covered borrower status once to obtain the safe harbor. 32 C.F.R. § 232.5. The search may be completed at the time:
 1. a consumer initiates the transaction or 30 days prior to that time;
 2. a consumer applies to establish the account or 30 days prior to that time; or
 3. the creditor develops or processes a firm offer of credit that includes the status of the consumer as a covered borrower, so long as the consumer responds to that offer within 60 days after the time the creditor provided that offer.

- A covered borrower search is not required for credit line increases, or “other customer management actions.” 80 Fed. Reg. 43578 (July 22, 2015).



Deep Dive – Determining MLA Eligibility, con't.

- **Potential Challenges:** Lenders have expressed concerns regarding potential credit bottlenecks that could be caused by the MLA Database safe harbor rules, as well as lack of clarity regarding the timing of covered-borrower searches.
 - There are legitimate questions regarding the MLA Database's ability to handle an increase in search activity. For example, the MLA Database was offline for several days in October 2014.
 - It is unclear when a transaction is “initiated” for purposes of conducting the search to obtain the benefits of the safe harbor.



Deep Dive – Calculating the MAPR

- **MAPR Calculation:** The MAPR is calculated using the same basic formula prescribed in Regulation Z for both closed-end and open-end credit, but with important additional elements, including:
 - credit insurance premiums;
 - finance charges (as defined in TILA);
 - application fees (except those charged by Federal credit union or insured depository institution making short-term, small amount loan);
 - participation fees; and
 - other fees for ancillary products. See 32 C.F.R. § 232.4(c).
- The MAPR requires an “effective APR” calculation for open-end credit.



Deep Dive – Calculating the MAPR, con't.

- **Exclusions:** The MAPR excludes certain fees on credit cards if the fees are “bona fide” and “reasonable.” See 32 C.F.R. § 232.4(d).
 - **Bona Fide:** While never fully defined, “bona fide” fees are those that are “expressly tied to specific products or services which may be imposed upon the covered borrower’s own choices regarding the use of the card.” 80 Fed. Reg. 43572 (July 22, 2015).
 - **Reasonable:** To determine whether a bona fide fee is reasonable, it “must be compared to fees typically imposed by other creditors for the same or a substantially similar product or service.” 32 C.F.R. § 232.4(d)(3)(i).
 - **Safe Harbor:** The new regulations provide a safe harbor for complying with the reasonableness requirement if the fee is equal to or less than the average of the amount charged by 5 other credit card issuers, each of whom meet a \$3 billion threshold in outstanding credit loans during the past 3 years, for a “like-kind” fee. 32 C.F.R. § 232.4(d)(3)(ii).



Deep Dive – Calculating the MAPR, con't.

- **Special Rules**: The new regulations also contain several rules for calculating the MAPR in special situations.
 - **Loss of Safe Harbor**: If a creditor assesses a fee that is not bona fide and reasonable (but could have been), then all fees must be included in the MAPR, including fees that were bona fide and reasonable. However, this rule does not apply where the assessed fee is always included in the MAPR (e.g., ancillary product fee). 32 C.F.R. § 232.4(d)(4)(ii).
 - **No Balance During Billing Cycle**: For open-end credit, in months with a zero balance, the creditor may not impose any fee during the billing cycle, except for a participation fee not to exceed \$100, unless the fee is bona fide and reasonable. 32 C.F.R. § 232.4(c)(2)(ii)(B).



Deep Dive – Calculating the MAPR, con't.

- **Potential Challenges**: The new rules leave many questions unanswered about the MAPR and create potential challenges.
 - **Bona Fide**: The assessment of whether a fee is “bona fide” appears to be left to the discretion of creditors, which presents the risk of regulators disagreeing with a good-faith determination.
 - **Reasonable**: The “reasonableness” determination requires creditors to obtain information regarding competitors’ fees, which can be difficult. And it is not clear when or how frequently the “reasonableness” determination must be made (annually, etc.).
 - **Scope of Ancillary Product Rule**: It is unclear the extent to which the rule including fees for ancillary products in the MAPR calculation applies where fees are for third-party products marketed in conjunction with a loan.



Penalties for Non-Compliance

- **Regulator Enforcement:** Compliance with the MLA will be enforced by the same regulators responsible for compliance with TILA. See 32 C.F.R. § 232.10.
 - Enforcement and supervisory authority over the MLA will vary depending on the size and nature of the institution, and will include the CFPB and the prudential regulators.

Penalties for Non-Compliance, con't.

- **Private Right of Action:** The MLA creates a private right of action and provides for the following:
 - Actual damages, but not less than \$500 for each violation;
 - Punitive damages;
 - Equitable or declaratory relief; and
 - Costs and attorneys' fees. See 32 C.F.R. § 232.9(e).
- **Defenses:** A creditor is not liable if it can show “by a preponderance of evidence that the violation was not intentional and resulted from a bona fide error notwithstanding the maintenance of procedures reasonably adapted to avoid any such error.” 32 C.F.R. § 232.9(e)(4).
- **Potential for Class Action:** *Cox v. Comm. Loans of Amer., Inc.*, 625 F. App'x 453 (11th Cir. Aug. 28, 2015).

Penalties for Non-Compliance, con't.

- **Void Contract**: Any credit agreement, note, or other contract with a covered borrower that fails to comply with the MLA is void from inception. 32 C.F.R. § 232.9(c).
- **Criminal Sanctions**: A creditor who “knowingly” violates the MLA or its regulations can be charged with a misdemeanor offense. 32 C.F.R. § 232.9(a).
 - Possible fine under Title 18 of the U.S. Code.
 - Possible imprisonment (up to one year).
 - Although the MLA provides for criminal liability, prosecutions are likely to be rare. The SCRA also provides for criminal penalties and criminal prosecutions are not common under the SCRA.

Relationship to Servicemember Laws

- **Covered Populations:** Although they both protect servicemembers, there are differences between the SCRA and MLA populations.
 - The MLA provides protections to borrowers who are servicemembers at the time of account origination. The SCRA provides benefits and protections to servicemembers who enter military service after account origination.
 - Unlike the SCRA, the MLA does not provide protections to reservists during an early notification period.
 - The MLA applies to “Active Guard and Reserve duty,” as defined in 10 U.S.C. § 101(d)(6), which is not covered by the SCRA.
 - The MLA extends protections to the dependents of servicemembers, while the SCRA only applies to servicemember dependents in limited circumstances.
 - Under both laws, protections terminate when the customer leaves military service.



Relationship to Servicemember Laws, con't.

- **Comparison of Interest Rate Benefit:** Although both the MLA and SCRA provide an interest rate benefit, they are different in several important respects.
 - **Maximum Rate:** The maximum allowable rate under the SCRA is 6%, while the rate under the MLA is 36%.
 - **Borrower Request:** A borrower must make a request to receive the SCRA interest rate benefit, while no request is needed under the MLA.
 - **Included Fees:** The SCRA interest rate includes most fees, including late fees. The MAPR under the MLA includes many fees, but it excludes bona fide and reasonable fees, and fees excluded from the finance charge under TILA (which includes late fees).
 - **Tail Period:** In certain circumstances, the interest rate benefit has a tail period following the end of military service under the SCRA. The MLA interest rate benefit terminates at the end of the qualifying military service period.



Relationship to Servicemember Laws, con't.

- **DMDC Databases**: The applicability of both the SCRA and MLA to borrowers can be checked on DMDC databases.
 - The MLA and SCRA databases are both based on DEERS, but they contain different information. For example, the MLA database contains information on servicemember dependents, while the SCRA database does not.

Compliance Environment – Overview

- **Increased Focus on Consumer Protection Issues**
- **Increased Focus on Servicemember Issues**
- **Increased Role of CFPB**
- **Increased Use of Enforcement Mechanisms**
- **“Double-Regulation”**



Compliance Environment – CFPB

- **CFPB Focus On Military Borrowers:** Military borrowers are a focus area for the CFPB and the MLA is likely to be closely supervised.
- “Protecting servicemembers is a priority for the CFPB,” said CFPB Director Richard Cordray. “We will use the authority Congress gave us to enforce the Military Lending Act and to safeguard our men and women in uniform from illegal payday loans.”
- The CFPB supported the revised MLA regulations during the notice and comment period. See Letter from Holly Petraeus, CFPB, to Sec. Chuck Hagel, DOD (Dec. 26, 2014).



Compliance Environment – SCRA

- **Lessons Learned From SCRA:** There are a number of lessons from SCRA enforcement that will be important to keep in mind in building an MLA compliance program, including:
 - Interpretation of law in favor of servicemembers
 - Low tolerance for potential violations
 - Expectations more rigorous than requirements of the law
 - Proactive identification of servicemember customers
 - Significant reputational risk



MLA Best Practices

- **Additional Items**: In addition to the general compliance recommendations and practices, lenders should also consider the following items when designing an MLA compliance program:
 - Engagement of SCRA and TILA specialists
 - Utilization of compliance framework for TILA and SCRA
 - Designated MLA owner in Legal, Compliance, and Audit
 - Company-wide MLA policy
 - Review business-level MLA procedures
 - Automation in application of interest rate benefit
 - Automation in conducting covered borrower checks and preserving evidence of check
 - Defined process for assessing bona fide and reasonable fees



Questions?

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