Uncle Sam Wants YOU to Comply with the Military Lending Act

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In July 2015, the Department of Defense amended its 2007 Military Lending Act regulations regarding consumer credit extended to active duty servicemembers and dependents ("covered borrowers"). Before the amendment, the MLA regulations applied only to payday loans, vehicle title loans, and tax refund anticipation loans. However, the amended MLA regulations apply to almost all "consumer credit," defined as "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." There are only three narrow exceptions to this broad definition, along with a temporary exclusion for credit cards:

Exclusion #1. Residential Mortgages.

Exclusion #2. Credit expressly intended to finance the purchase of a motor vehicle, when the credit is secured by the vehicle being purchased.

Exclusion #3. Credit expressly intended to finance the purchase of personal property, when the credit is secured by the property being purchased.

While it's tempting to read Exclusions #2 and #3 as covering all purchase-money financing of motor vehicles and personal property, we suggest a different possibility. The regulations and Supplemental Information do not define the phrase "expressly intended." As such, it could be interpreted to mean that such transactions are exempt only to the extent they finance the vehicle or personal property. For example, many vehicle purchase transactions bundle the purchase of the vehicle with ancillary products and services, like extended warranties and GAP coverage. Unfortunately, the MLA regulations do not clearly address these bundled transactions.

Likewise, we caution that "side notes" commonly entered into with buyers for financing vehicle repairs are covered by the MLA's definition of "consumer credit," depending on how they are structured. That is, unless the "side note" is properly set up to expressly finance the purchase of personal property and is secured by the property being purchased, it is covered under the MLA. There is no exclusion for financing services (as opposed to goods).

So what does the MLA require? The MLA's stated purpose is to provide certain specific protections to "covered borrowers." These protections fall into two main categories:

(1) a 36% Military Annual Percentage Rate ("MAPR") cap; and

(2) "other MLA terms and conditions" providing additional consumer protections.

The MAPR is an all-inclusive APR that eliminates some prior "finance charge" exceptions under Regulation Z. For example, the MAPR calculation must include (a) fees/premiums charged for voluntary credit insurance, debt cancellation contracts, and debt suspension agreements, and (b) fees for any ancillary products sold in connection with the consumer credit. The MLA also requires that "covered borrowers" be provided with oral and written disclosures regarding their rights under the MLA. In addition, the MLA prohibits, among other things, vehicle title-secured transactions, mandatory arbitration clauses, and contractual waivers of rights under any state or federal laws, such as the Servicemembers Civil Relief Act.

Since the MLA applies to consumer credit transactions with "covered borrowers," creditors need to determine whether an applicant is a "covered borrower." The prior rule gave creditors a safe harbor for such determinations by allowing an applicant to complete a self-attestation regarding his or her status. However, due to concerns about "widespread misuses" of the self-attestations, the safe harbor offered by the amended MLA regulations is not conditioned upon these forms. Instead, creditors must directly or indirectly (perhaps through a service provider) verify the applicant's "covered borrower" status through the Department's MLA database. Creditors may also verify the consumer's "covered borrower" status by using a consumer report obtained from a nationwide consumer reporting agency that has "a statement, code or indicator (if any) concerning the consumer's status." Doing so, and keeping a record of the findings, provides a creditor with a safe harbor.

If you've read this far and you're still wondering why compliance with the MLA is such a big deal, be aware that the penalties for violations are severe. Knowing violations are treated as misdemeanors, which can lead to fines or imprisonment. Civil penalties include having the loan/credit transaction declared void from inception (that is, the creditor cannot collect the principal advanced or any finance charges), $500 per violation in actual damages, punitive damages, equitable or declaratory relief, court costs, and attorney's fees. In addition, private rights of action are allowed, which could, of course, expose companies to class action litigation.

Simply deciding not to do business with "covered borrowers" may not be an option. Do you really want to be on the front page of the paper with a headline declaring that your company refuses to do business with military members and their families? In addition, denying applicants based on "covered borrower" status raises more risks than just bad publicity. Certain states, such as California, have enacted laws prohibiting discrimination against servicemembers on the basis of their military status. Also, keep in mind that federal law prohibits discrimination on the basis of marital status. Denying "covered borrowers" simply because they are married to active duty servicemembers could be deemed a violation of these federal protections.

All non-exempt consumer credit transactions entered into with "covered borrowers" on or after October 3, 2016, must comply with the MLA regulations. Though the Supplemental Information released with the MLA regulations is helpful in discerning the meaning behind some of the MLA's ambiguous provisions, it still leaves many unanswered questions. Until the Department releases further commentary and courts begin to issue rulings that address some of these unanswered questions, we are left only with the plain language of the MLA regulations and our best guess as to how to interpret it. Given the draconian penalties associated with violating the MLA, we suggest a conservative approach. Accordingly, if you've been putting MLA compliance on the back burner because you thought there was really nothing to worry about, we suggest you take another look.

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