

# Client Alert

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## Department of Defense Issues New Guidance on Military Lending Act Regulations

By Leonard N. Chanin, Obrea O. Poindexter, and Ryan J. Richardson

On August 26, 2016, the Department of Defense (DOD) issued an interpretive rule providing guidance on the DOD's regulations implementing the Military Lending Act (MLA). Specifically, the interpretive rule aims to clarify certain ambiguities in the DOD's July 2015 final rule, which significantly expanded the scope of the MLA to cover new types of creditors and new credit products. Presented in a series of questions and answers—19 in total—the interpretive rule by no means resolves all ambiguities present in the July 2015 final rule. The interpretive rule does, however, provide much needed clarity on a handful of issues that are critical to creditors' compliance with the MLA. In this alert, we offer a high-level summary of some of the most significant issues addressed by the interpretive rule, with a more detailed alert to follow.

### BACKGROUND

Following a September 2014 notice of proposed rulemaking, the DOD finalized sweeping changes to the rules that implement the MLA on July 22, 2015. The amended MLA rules cover a far broader range of creditors and credit products than were covered under the previous rules. Most notably, under the previous DOD rules, the MLA generally applied only to "payday" loans, vehicle title loans, and refund anticipation loans. Under the amended 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.

As market participants studied the July 2015 final rule, multiple operational and compliance quandaries emerged. In turn, Morrison & Foerster, along with major trade associations, urged the DOD to resolve critical ambiguities in the final rule sufficiently in advance of October 3, 2016, when creditors must be in compliance with the rule. The interpretive rule is the DOD's response to these appeals.

The interpretive rule does not change the date by which creditors must comply with the MLA rules. Thus, except for credit cards, creditors must comply by October 3, 2016. (Compliance with the rules for credit cards is delayed until October 3, 2017, unless extended for an additional year until October 3, 2018.) Additionally, because the interpretive rule merely clarifies existing MLA regulations (i.e., it does not amend or otherwise change the regulations implementing the MLA), it is not subject to a public comment period. Thus, the interpretive rule will be effective immediately upon publication in the Federal Register (August 26, 2016).

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## CLARIFICATIONS MADE BY THE INTERPRETIVE RULE

As noted above, the interpretive rule is comprised of 19 questions and answers (Q&As). The most significant compliance and operational issues addressed among the Q&As are as follows:

- *Payments by check and electronic fund transfer are permitted.* Under the MLA rules, section 232.8(e) 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 the covered borrower. Many observers interpreted this provision to bar creditors from accepting payment from covered borrowers by check and electronic fund transfer. The interpretive rule clarifies that section 232.8(e) is intended to prohibit creditors from creating remotely-created checks and/or using post-dated checks provided by the borrower when 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 electronic fund transfer.
- *A general description of the borrower’s payment obligation is sufficient when providing oral disclosures.* Under the MLA rules, 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 such disclosures to be made in writing and orally. Oral disclosures can be provided in person or via a toll-free telephone number. The MLA rule does not make clear what, exactly, the disclosures must contain. The interpretive rule clarifies that creditors may provide a general description of how the payment obligation is calculated, as long as that description is clear and accurate. Thus, the payment obligation disclosure need not reflect the specific terms of a credit agreement or credit transaction.
- *Creditors need not generate special credit agreements for covered borrowers. A uniform agreement with a savings clause is permitted.* Under the MLA rules, section 232.8 prohibits a creditor from including certain proscribed terms and provisions (e.g., a mandatory arbitration provision) in the agreement governing an extension of credit with a covered borrower. Many observers were concerned that this provision might be read to require creditors to generate special credit agreements for covered borrowers that omit the proscribed terms. The interpretive rule clarifies that creditors may use the same agreement for covered and non-covered borrowers, provided the agreement contains a savings clause, which limits application of the proscribed terms to non-covered borrowers.

Additional issues addressed among the Q&As include:

- Application of the MLA rules to specific credit products (i.e., overdrafts, hybrid secured/unsecured loans to purchase personal property);
- Calculation and application of the military annual percentage rate (MAPR), including application of the safe harbor for creditors to exclude from MAPR reasonable and bona fide fees charged to a credit card account;
- Permission and obligation to check the military status of a borrower, including application of the covered borrower identification safe harbor;
- Timing and delivery of required disclosures in writing and by use of a toll-free telephone number; and
- Permission to take a security interest in a covered borrower’s checking, savings, or other financial account in connection with a credit transaction.

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Our forthcoming alert will provide a more detailed discussion of the full range of issues addressed by the interpretive rule, as well as significant takeaways for market participants.

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