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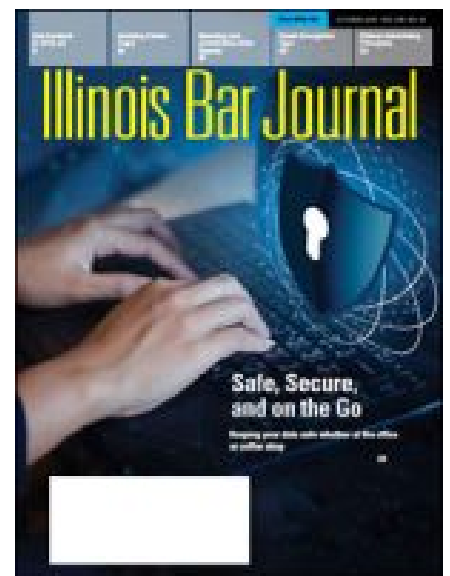
Debtors and Creditors

The Sharpened Teeth of the Military Lending Act

By [Michael D. Schag](#)

The Military Lending Act's fairly stringent lending restrictions have been expanded to include consumer credit card issuers, unsecured consumer lenders, and depository institutions. Intended to more broadly protect servicemembers from predatory lending practices, the expanded regulations took effect on Oct. 3, 2017. Some lenders were given until Oct. 3, 2018, to be fully compliant.

Proposed as the Talent-Nelson amendment, the



TAKEAWAYS:

- The U.S. Military Lending Act (MLA) was designed to deter lenders from charging excessive fees and interest rates, establishing unrealistic payment schedules, and taking advantage of U.S. military servicemembers. During the past decade, the MLA has been amended to regulate more and more credit products.
- The most prominent feature of the MLA is the Military Annual Percentage Rate (MAPR), which

Military Lending Act ("MLA") passed into law in 2006 as Section 670 of the John Warner National Defense Authorization Act¹ for fiscal year 2007. Congress took this action in response to a 2006 Department of Defense ("DoD") report that concluded "predatory lending undermines military readiness, harms the morale of troops and their families, and adds to the cost of fielding an all-volunteer fighting force."²

Who is covered under the Military Lending Act

The MLA applies to military, active Reserve, and National Guard personnel on active duty³ and their dependents⁴ with a valid military

identification card (roughly 44,000 adults from Illinois serve on active duty or are in the Reserves, according

to the DoD's Manpower Data Center). Active duty means being called up or ordered to serve more than 30 days. Qualifying dependents must have relied on a servicemember for more than half of their financial support for 180 days immediately preceding an extension of credit. The MLA does not cover retirees, members not on active duty, or civilian employees of the DoD unless they are dependents of a covered borrower. The MLA's restrictions only apply to accounts opened while the servicemember or dependent is

caps loans given to servicemembers and their dependents at an annual rate of 36 percent. The original MLA also prohibited the securing of loans with checks, electronic access to bank accounts, vehicle titles, and allotment of military pay.

- The MAPR's 36 percent cap remains in place, although the expanded rule allowed some credit card companies a two-year exemption from MAPR until Oct. 3, 2017-unless extended for an additional year until Oct. 3, 2018. Notably, the MAPR is not the same as the interest rate on the loan and is also not the annual percentage rate disclosed pursuant to Regulation Z, which implements the Truth in Lending Act.



eligible; the MLA's protections end when the consumer is no longer covered under the MLA. Lenders must use standard loan application language to determine whether borrowers are covered servicemembers or dependents and can query a DoD database to verify active-duty status.⁵

MLA's initially narrow protections

In its initial form, it was unclear whether the MLA gave rise to a private right of action for violations. But the MLA did make clear that its remedies would be "in addition to and do not preclude any remedy otherwise available under State or Federal law...including any award for consequential damages and punitive damages."⁶

The most prominent feature of the MLA is the Military Annual Percentage Rate (MAPR), which caps loans given to servicemembers and their dependents at an annual rate of 36 percent. The original MLA also prohibited the securing of loans with checks, electronic access to bank accounts, vehicle titles, and allotment of military pay. It required that servicemembers have access to the judicial system to resolve complaints. The MLA also excluded mortgages and automobile finance loans.

The MLA was designed to deter lenders that charged excessive fees and interest rates, established unrealistic payment schedules, and disregarded a borrower's ability to repay. However, prior to the final rule which took effect in October 2015, the MLA had applied rate caps and other protections to only three consumer credit products: *closed-end payday loans* no greater than \$2,000 and with repayment terms of 91 days or less, *closed-end vehicle title loans* with repayment terms of 181 days or less, and *closed-end tax refund anticipation loans*. Notably, home equity loans, lines of credit, reverse mortgages, and vehicle loans were not covered under the MLA when initially enacted.

The MLA also did not cover many other forms of credit. No open-end credit arrangement was covered, including credit cards, bank overdraft lines of credit, and bona fide open-ended payday or vehicle title loans. Debts to a bank that could be paid by extracting deposited funds, such as in the case of overdraft loans, were not covered. The MLA regulations did not cover credit that was not subject to Truth in Lending Act disclosures—again, for such things as overdraft loans. They also did not cover military installment loans or any installment loans not secured by a check or electronic access to an account. Rent-to-own agreements and retail sales credit were not covered. Regulations did not cover credit transactions to finance the purchase or lease of personal property when the credit

was secured by the property. Credit secured by a qualified retirement account was not covered.

Although there were plenty of types of credit arrangements not covered by the MLA, it was viewed by many as a success. A spokesman for the Navy-Marine Corps Relief Society told the Army Times in April 2010 that his organization had seen a 75-percent reduction in U.S. servicemembers requesting assistance related to payday loans since 2006.⁷

Perhaps predictably, in response to the enactment of the MLA, some lenders designed loans that bypassed MLA protections. Payday lenders in Illinois restructured 350-percent-interest loans as 121-day installment loans to avoid the 120-day-minimum-loan term established by the state. Military members would not enjoy MLA protection under such plans because the MLA applied only to loans of 91 days or less. Some lenders characterized payday or car title loans as open-end credit arrangements. More amendments followed.

Greater oversight: The MLA's 2013 amendments

Amendments to the MLA appeared in Sections 661-663 of the National Defense Authorization Act for fiscal year 2013. Those amendments allowed a covered borrower to recover damages from a creditor who violates a requirement of the MLA. Prior to the amendment, there had been a substantial legal question as to whether a private right of action existed under the MLA. Those amendments also vested the agencies specified in Section 108 of the Truth in Lending Act⁸ with enforcement authority. This includes the Federal Trade Commission and federal banking agencies. Remedies included restitution to the consumer. In addition, the amendments altered the definition of "dependent" to achieve consistency with how that term had been used for determining eligibility for medical care.⁹ Finally, the amendments established a requirement that the DoD consult with other federal agencies at least biannually to review and revise MLA regulations.

From many exceptions to few: The 2015 amendments

Further amendments were proposed in September 2014 with the purpose of "extending the protections of [the MLA] to a broader range of closed-end and open-end credit products rather than the limited credit products that had been defined as 'consumer credit.'"¹⁰ While the MLA's original restrictions only applied in a few relatively narrow areas of consumer credit, the amended regulations¹¹ captured nearly all credit products. The DoD revised its definition of "consumer credit" to encompass credit offered or extended to

a covered borrower for primarily personal, family, or household purposes. The revised definition also included credit that is subject to a finance charge or payable by a written agreement in more than four installments.¹²

This broader definition is more closely aligned with the Truth in Lending Act. Its expansion most notably includes credit cards and student loans. The final rule also encompasses installment loans, vehicle title loans, payday loans, refund anticipation loans, deposit advance loans, and open-end lines of credit.

Some exceptions remain outside of MLA's scope: loans for purchasing or refinancing a home, home equity lines of credit, auto loans secured by the purchased vehicle, and personal property loans secured by the purchased property. On the other hand, an automobile refinancing loan no longer is exempt.

Military Annual Percentage Rate considerations

The MAPR's 36 percent cap remains in place, although the expanded rule allowed some credit card companies a two-year exemption from MAPR until Oct. 3, 2017-unless extended for an additional year until Oct. 3, 2018. Notably, the MAPR is not the same as the interest rate on the loan and is also not the annual percentage rate disclosed pursuant to Regulation Z, which implements the Truth in Lending Act. The MAPR includes interest, fees, credit service charges, credit renewal charges, credit insurance premiums, and other fees assessed in connection with the loan. However, be advised that the regulations directing MAPR calculations are detailed, and credit cards have their own rules for assessing MAPR. For closed-end credit, the MAPR will be calculated at the time the loan is made or before. For open-ended credit agreements, the MAPR will be calculated with each billing cycle.

The MAPR's 36 percent rate also includes finance charges under Regulation Z and other charges covered as interest. Even if certain charges are not considered finance charges under Regulation Z, they still are required to be included in the MAPR. These include application, participation, and annual fees as well as credit insurance premiums and fees for debt cancellation or debt suspension agreements. Fees for credit-related ancillary products sold in connection with the credit transaction or account also are to be included in the MAPR.

Under the MLA, "any fee imposed for participation in any plan for consumer credit" is included in the MAPR, except for a bona fide fee charged to a credit card account.¹³ Fees

that are deemed to be both "bona fide" and "reasonable" under the MLA will be exempt from MAPR calculations. Under the MLA, a fee is bona fide when it is assessed for specific products or services based upon the use of the account. Examples include participation, cash advances, or foreign transaction fees. Under the Act, a bona fide participation fee may be "reasonable" if the creditor can demonstrate the fee either extended more credit or provided some meaningful value for the higher participation fee.¹⁴

Targeting payday loans

A creditor cannot "use a check or other method of access to a consumer's deposit, savings, or other financial account." This provision obviously was aimed at payday-loan practices. However, three exceptions apply. A creditor may: require an electronic fund transfer to pay the transaction; require direct deposit of the consumer's salary as a condition of eligibility for the credit; or take a security interest in funds deposited after the extension of credit in an account created for the credit transaction-so long as other applicable laws (usually deriving from the state) do not otherwise prohibit the action. Ambiguities surrounding this provision will likely generate additional controversies.

Creditors are required to disclose, both orally and in writing, the interest rate and fees owed by the consumer before the loan is issued. They are prohibited from requiring covered borrowers to submit to arbitration should a legal dispute arise in connection with the loan agreement. They also are prohibited from rolling over or refinancing the same loan unless the refinancing results in more favorable terms for the consumer. Creditors are prohibited from assessing any penalties when a borrower prepays all or part of a loan. Loan agreements cannot require a borrower to waive rights to recourse as provided under any state or federal law, including the Servicemembers Civil Relief Act.¹⁵

Any credit agreement prohibited under the MLA is "void from inception." Enforcement has been enhanced to make clear that covered borrowers may recover damages from a creditor who violates the MLA. There has been at least one class action certified under the MLA against automobile title loan companies on the basis of exceeding the MAPR.¹⁶ Moreover, the MLA authorizes government agencies to enforce the requirements of the MLA using administrative penalties. While a majority of states permit payday lending, a few, including Illinois, also authorize state regulators to enforce the MLA.¹⁷

Consequences of violating the MLA

Criminal. A creditor who knowingly violates the MLA shall be fined no more than \$10,000 and/or imprisoned for no more than one year.¹⁸

Civil liability. In 2012, Congress added a private right of action to the MLA for violations that took place in, or after, 2013. A person who violates the MLA with respect to any person is civilly liable to such person for: 1) any actual damages sustained as a result, but not less than \$500 for each violation; 2) appropriate equitable and declaratory relief; and 3) any other relief provided by law, including any award for consequential and punitive damages.¹⁹

Any credit agreement, promissory note, or other contract prohibited by the MLA is considered void from the contract's inception. This could require a lender to identify and refund all fees and interest paid by the borrower. Further, no agreement to arbitrate any dispute involving the extension of consumer credit shall be enforceable against any covered member, dependent, or anyone who was a covered member or dependent when the agreement was made.²⁰

Liability for costs and attorney fees. In any successful action to enforce civil liability against a creditor under the MLA, that creditor also will be liable for the costs of the action and reasonable attorney fees. However, should the defendant prevail and show the action was brought in bad faith and for the purpose of harassment, the plaintiff is liable for the defendant's reasonable attorney fees.²¹

Administrative enforcement. The provisions of the MLA also are enforced by the same agencies and in the same manner specified in Section 108 of the Truth in Lending Act.²² The Consumer Finance Protection Bureau (CFPB) and the Federal Trade Commission (FTC) are mainly responsible for overall enforcement of the MLA. These agencies can use all of the functions and powers available to them under their respective acts to force anyone to comply with the MLA or any other applicable authority, irrespective of whether that person is engaged in commerce or meets any other jurisdictional tests under the FTC Act.²³

In addition to seeking their own private counsel, servicemembers are encouraged to file complaints with the FTC Consumer Sentinel, the CFPB, and the applicable state credit regulator when a lender fails to comply with MLA regulations.

Remedies

The CFPB has broad authority to enforce federal consumer finance laws, rules, and orders-including the MLA-through a civil court action or an administrative adjudication proceeding. (Some news outlets recently have reported that the Executive branch under the current administration is aiming to relax enforcement under the MLA. If this transpires, it likely would tend to loosen constraints on financial institutions to some extent. Yet, while relief for servicemembers could become more elusive as a practical matter, it would take another legislative amendment to obviate many of the protections afforded them.) Upon a finding in favor of the bureau, enforcement powers include: rescission of contracts; ordering the refund or return of money or real property; payment of damages; public notification regarding the violation; limits on activities or functions of a person; and civil money penalties up to \$5,000 per day for first-tier violations, \$25,000 per day for second-tier violations, and up to \$1 million per day for third-tier violations.

Factors determining the appropriate penalty include the financial resources and good faith of the person charged, the gravity of the violation or failure to pay, the severity of risks or losses to the consumer, and the defendant's history of prior violations.²⁴ For example, in 2013, a payday lender was found to have illegally overcharged servicemembers and was ordered to refund up to \$14 million to borrowers, dismiss all pending lawsuits to collect against covered borrowers, pay a \$5 million civil penalty, and improve internal compliance protocols.²⁵



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ISBA RESOURCES >>

Grant T. Swinger, [*A Guide to the Illinois Service Member Civil Relief Act*](#), 101 Ill. B.J. 478 (Sept. 2013).

Illinois Law Update, [Amendments to Payday Loan Reform Act Affect Military Members](#), 101 Ill. B.J. 124 (Mar. 2013).

Steven B. Bashaw, [Active Duty Military: A Special Class of Distressed Homeowners](#), 99 Ill. B.J. 532 (Oct. 2011).

1. 10 U.S.C. § 987.
2. Department of Defense, [Report on Predatory Lending Practices Directed at Members of the Armed Forces and Their Dependents](#) (Aug. 9, 2006), P. 9.
3. See 10 U.S.C. § 101(d)(6).
4. See 38 U.S.C. § 101(4).
5. mla.dmdc.osd.mil/; see also www.dmdc.osd.mil/appj/scra/.
6. 32 C.F.R. § 232.9(b) (2006).
7. See Michael D. Schag *et al.*, Legal Guide for Military Families, American Bar Association (1st ed. 2013).
8. 15 U.S.C. § 1601; 12 C.F.R. § 226.
9. Cf. 10 U.S.C. § 1072 (which includes spouses, same-sex spouses, children, and certain unremarried former spouses).
10. 80 Fed. Reg. 43559 (July 22, 2015).
11. 32 C.F.R. § 232.
12. See 12 C.F.R. § 1026.1(C)(1)(iii).
13. See 32 C.F.R. § 232.4(c)(1)(iii)(C).
14. See *Id.* § 232.4(d)(3)(iv).
15. 50 U.S.C. § 501 *et seq.*; see also Michael D. Schag *et al.*, Servicemember and Veterans Rights, Matthew Bender (2011); Michael D. Schag *et al.*, Military Service and the Law, IICLE (2009); Michael D. Schag, *Finding Your Way around the Servicemembers Civil Relief Act*, 95 Ill. B.J. 76 (Feb. 2017).
16. *Jason M. Cox v. Community Loans of America, Inc.*, No. 14-12977 (11th Cir. 2015).
17. 815 ILCS 122/2-51.

18. 10 U.S.C. § 987.

19. *Id.*

20. *Id.*

21. *Id.*

22. *Id.*

23. 12 U.S.C. § 1607.

24. *Id.* at § 5565.

25. www.consumerfinance.gov/about-us/newsroom/consumer-financial-protection-...

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