Department of Defense Final Rule
Limitations on Terms of Consumer Credit Extended to Service Members and Dependents

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DISCLAIMER

THE INFORMATION PROVIDED HEREIN IS GENERAL INFORMATION AND IS NOT TO BE CONSIDERED LEGAL ADVICE ABOUT THE SUBJECT MATTERS COVERED OR ANY SPECIFIC LEGAL ISSUE. THE ADVICE OF AN ATTORNEY SHOULD BE OBTAINED AS APPROPRIATE TO SPECIFIC ISSUES AND FACTUAL SITUATIONS
Department of Defense Final Rule
Limitations on Terms of Consumer Credit Extended to Service Members and Dependents

Effective Date: October 1, 2015 – COMPLIANCE MANDATORY OCTOBER 3, 2016
32 CFR Part 232
80 F.R. 43560 July 22, 2015

The Department of Defense issued a final rule that amends its existing rules governing rates, terms and conditions of loans to active-duty service members (the “Rule”). The Rule is effective October 1, 2015, however, compliance with the final rule is not mandatory until October 3, 2016; for credit cards, compliance is not mandatory until October 3, 2017.

Coverage of the Rule
The Rule generally applies to loans made to active-duty service members and their dependents for personal, family or household use. A one-time determination that borrower is an active-duty service member must be made at the time an account is established or before the borrower becomes obligated on the credit transaction. The requirements of the Rule cease to apply when active-duty status is terminated. That is, a loan that may have been subject to the Rule when originated, ceases to be subject to the Rule when the service member is no longer on active-duty status.

Loans Not Covered (Exceptions)
The Rule does not apply to loans secured by an interest in a dwelling (whether or not attached to real property), purchase-money vehicle loans, purchase-money loans for personal property, and loans exempt from coverage of Regulation Z (e.g., business, agricultural, and securities credit).

Determination of Borrower’s Status
The credit union must determine whether a borrower is covered by the Rule at the time an account is established or before the borrower becomes obligated on the credit transaction. The credit union may determine whether a borrower is covered under the Rule using any method, however, the Rule provides a safe harbor when the credit union uses the Department of Defense (“DOD”) database or a consumer report obtained from a consumer reporting agency to make the determination. Use of the DOD database or a credit bureau is deemed a “conclusive determination” of a borrower’s status so long as the credit union maintains a record of the information.

Military Annual Percentage Rate (MAPR)
The credit union must not extend credit to a covered borrower at rate exceeding 36% MAPR. The MAPR is calculated differently than the APR under Regulation Z, and many fees excluded from the calculation under Regulation Z are included in the MAPR. The actual numeric percentage rate need not be disclosed to the borrower, but it cannot exceed 36%. In addition to the disclosures required by Regulation Z, the borrower must be provided with a “statement of the MAPR” but, as previously stated, need not include the calculated numeric percentage rate. The credit union may use the model statement provided in the rule. The statement of the MAPR must also be given orally.
Other Disclosures
The credit union must provide the borrower with any disclosures required by Regulation Z and “a clear description of the payment obligation.” The description of the payment obligation must be provided both in writing and orally. The Regulation Z disclosures given to the borrower by may be used to satisfy the written disclosure requirement.

Prohibited Acts and Practices
The Rule prohibits a credit union from requiring a borrower to waive any legal right of recourse, requiring the borrower to submit to arbitration, imposing onerous legal notice provisions in case of dispute, requiring unreasonable notice from the borrower as a condition for legal action, or prohibiting prepayment of a loan or charging a penalty fee for prepayment.
I. Coverage.
   a. The Rule applies to (“consumer credit”)
      i. Loans (made directly or taken by assignment) for personal, family or household
         purposes that are either
         1. Subject to a finance charge (as defined by Regulation Z), OR
         2. Payable by a written agreement in more than four installments, AND
      ii. Made or offered to a “Covered Borrower.” A Covered Borrower is a consumer (or the
         consumer’s dependent) who, at the time the consumer becomes obligated on a
         consumer credit transaction or establishes an account for consumer credit, is a member
         of the armed forces serving on
            1. Active duty under a call or order of more than 30 days, OR
            2. Active Guard and Reserve duty
   b. Dependent means
      i. a spouse
      ii. a child who
         1. has not attained the age of 21,
         2. has not attained the age of 23, is enrolled in a full-time course of study at an
            institution of higher learning approved by the administering Secretary and is, or
            was at the time of the member's or former member's death, in fact dependent on
            the member or former member for over one-half of the child's support, OR
         3. is incapable of self-support because of a mental or physical incapacity that
            occurs while a dependent of a member or former member under clause (i) or (ii)
            and is, or was at the time of the member's or former member's death, in fact
            dependent on the member or former member for over one-half of the child's
            support
      iii. a parent or parent-in-law who is, or was at the time of the member's or former member's
            death, in fact dependent on him for over one-half of his support and residing in his
            household, AND
      iv. an unmarried person who
         1. is placed in the legal custody of the [service] member or former [service] member as
            a result of an order of a court of competent jurisdiction in the United States (or
            possession of the United States) for a period of at least 12 consecutive months
         2. either
            a. has not attained the age of 21
            b. has not attained the age of 23 and is enrolled in a full time course of study at
               an institution of higher learning approved by the administering Secretary; or
            c. is incapable of self support because of a mental or physical incapacity that
               occurred while the person was considered a dependent of the service
               member or former service member under a. or b. above
         3. is dependent on the service member or former service member for over one-half of
            the person's support
4. resides with the service member or former service member unless separated by the necessity of military service or to receive institutional care as a result of disability or incapacitation or under such other circumstances as the administering Secretary may by regulation prescribe, AND
5. is not a dependent of a service member or a former service member under any other provision of the law

c. Exception for Certain Loans. The Rule does NOT apply to
i. Any credit transaction secured by an interest in a dwelling
ii. Any credit transaction expressly intended to finance the purchase of a motor vehicle when the credit is secured by the vehicle being purchased
iii. Any credit transaction expressly intended to finance the purchase of personal property when the credit is secured by the property being purchased, OR
iv. Any credit transaction that is exempt from coverage of Regulation Z

d. Former Service Members. The Rule does not apply to a borrower who ceases to meet the definition of a Covered Borrower above.

II. Maximum APR

a. MAPR. MAPR is the Military Annual Percentage Rate. A covered transaction must not have a MAPR that exceeds 36%. The MAPR is calculated using the same formula (or equation) that is used to calculate the APR under Regulation Z. However, the fees and charges included in the calculation are more extensive than under Regulation Z. That is, many fees or charges that are excluded from the calculation under Regulation Z are NOT excluded for purposes of calculating the MAPR.

b. Fees and Charges Included in the MAPR Calculation. Fees and charges to be included in the calculation of the MAPR are:
   i. Any credit insurance premium or fee, any charge for single premium credit insurance, any fee for a debt cancellation contract, or any fee for a debt suspension agreement
   ii. Any fee for a credit-related ancillary product sold in connection with the credit transaction for closed-end credit or an account for open-end credit; and
   iii. Except for a bona fide fee (discussed below) which may be excluded from the calculation (other than a periodic rate)
      1. Finance charges associated with the consumer credit
      2. Any application fee charged to a covered borrower who applies for consumer credit other than an application fee charged by a Federal credit union or an insured depository institution when making a short-term, small amount loan, provided that the application fee is charged to the covered borrower not more than once in any rolling 12-month period), and
      3. Any fee imposed for participation in any plan or arrangement for consumer credit, subject to paragraph (c)(2)(ii)(B) of this section

c. Computation of the MAPR
   i. Closed-End Credit. For closed-end credit, the MAPR is calculated following the rules for calculating and disclosing the “Annual Percentage Rate (APR)” for credit transactions under Regulation Z. Again, however, the calculation must include the fees listed in b. above regardless of whether those fees may be excluded in the calculation of the APR
   ii. Open-End Credit.
      1. General Rule. For open-end credit, the MAPR is generally calculated following the rules for calculating the effective annual percentage rate for a billing cycle under Regulation Z (sections 1026.14(c) and (d)). The calculation must include the fees listed in b. above; that is, if the fees and charges are of the type listed in b. above, they must be included in the calculation even if they are allowed to be excluded for purposes of Regulation Z.
2. No Balance During Billing Cycle. If there is no balance during the billing cycle, the credit union may not impose any fee or charge during that billing cycle except for a participation fee that does not exceed $100 annually. The $100 limitation does not apply to a bona fide Participation Fee in connection with a credit card account as discussed below.

d. Bona Fide Fees for Credit Card Accounts.
   i. Definition. The term “bona fide fee” is not defined in the Rule. The term “bona fide” generally means “in good faith; without fraud or deceit.” See Barron’s Law Dictionary. See also Merriam Webster’s Dictionary. Examples of bona fide fees included in the Rule and the preamble to the Rule include “cash advance fees” and “foreign transaction fees.”
   ii. Exclusion from the MAPR. A bona fide fee is NOT required to be included in the calculation of the MAPR for credit card accounts if it is “reasonable.” The term bona fide fee does NOT include any periodic rate, any credit insurance premium or fee, including any charge for single premium credit insurance, any fee for a debt cancellation contract, or any fee for a debt suspension agreement, or any fee for a credit-related ancillary product sold in connection with the credit transaction for closed-end credit or an account for open-end credit.
   iii. Reasonableness of a Bona Fide Fee. For a bona fide fee to be excluded from the calculation of the MAPR, the fee must be reasonable. To determine if a fee is reasonable, the fee must be compared to fees typically imposed by other creditors for the same or a substantially similar product or service. For example, to determine if a “cash advance” fee is reasonable, the credit union would compare it to cash advance fees charged by other creditors.
      1. Safe Harbor. A bona fide fee will be considered reasonable if it is equal to or lower than the average fee for the same or similar fee charged by 5 or more creditors that each have outstanding credit card balances of $3 billion or more at any time during the 3-year period preceding the time such average is computed.
      2. Fees Greater Than the Safe Harbor. A bona fide fee may still be considered reasonable even if it is higher than the safe harbor amount, depending on other factors (such as value of the product or service relative to the fee). A bona fide fee is NOT unreasonable solely because other creditors do not charge a fee for the same or similar product or service.
   iv. Effect of Charging Non-Bona Fide (Unreasonable) Fees. If a credit union charges BOTH bona fide fees and non-bona fide fees, ALL fees (that is, both bona fide and non-bona fide fees) must be included in the calculation of the MAPR.
   v. Reasonableness of a Participation Fee. The Rule states that the amount of a participation fee “may” be reasonable if the amount of the fee reasonably corresponds to
      1. the credit limit in effect or credit made available when the fee is imposed,
      2. the services offered under the credit card account, OR
      3. other factors relating to the credit card account.
   e. Short-Term, Small Amount Loans (“STSA”). As previously mentioned, an application fee is generally required to be included in the calculation of the MAPR. However, such a fee is NOT required to be included in the calculation of the MAPR for STSA loans.
      i. Definition of STSA. The Rule defines a STSA loan as a
         1. Closed-end loan
         2. Subject to and made in accordance with a federal law (other than the MLA) that
            a. expressly limits the rate of interest (to no more than 36%) that a Federal credit union or an insured depository institution may charge on an extension of credit
            b. Limits the maximum maturity term to no more than 9 months, AND
c. Limits the amount of any application fee that may be charged to an applicant, AND
3. Made in accordance with the requirements, terms, and conditions of a rule, prescribed by the appropriate federal agency (or jointly among agencies) that implements the law

III. Determination of “Covered Borrower”

a. Method of Determination. A credit union may use any method it chooses to determine if a borrower is subject to the protections of the Rule; that is, to determine if a consumer is a Covered Borrower. However, if a credit union’s determination is incorrect, it will be in violation of the MLA and the Rule unless the determination was made in accordance with one of the safe harbor methods.

b. Safe Harbor Determination. The Rule provides two safe harbor methods for determining whether a borrower is a Covered Borrower.

i. Department of Defense Database. The credit union may verify the status of a borrower by using information obtained from the DOD database at www.dmdc.osd.mil/mla/welcome.xhtml. The credit union must provide the borrower’s last name, date of birth and Social Security number. NOTE: The link provided is taken from the regulation and, at this time, appears to be inactive and non-functional. We will update you if the web address is changed.

ii. Credit Bureau. The credit union may verify the status of a borrower by using the statement, code or similar indicator describing the status, if any, contained in a consumer report obtained from a consumer reporting agency that compiles and maintains files on consumers on a nationwide basis or a reseller of such reports.

c. Lookback Prohibited. After the loan is made or the account is established, a credit union may not obtain, directly or indirectly, any information from any DOD database to determine whether a borrower had been a Covered Borrower at the time the loan was made or the account was established.

d. Time of Determination. A borrower’s status is only required to be determined once. That is, there is no need for ongoing monitoring to determine if borrower enters active duty service after the loan is made or the account is established. A credit union must make the determination of the borrower’s status only at the time

i. A consumer initiates the transaction or 30 days prior to that time,

ii. A consumer applies to establish the account or 30 days prior to that time, OR

iii. The credit union develops or processes, with respect to a consumer, a firm offer of credit that (among the criteria used by the credit union for the offer) includes the status of the consumer as a Covered Borrower, so long as the consumer responds to that offer not later than 60 days after the time that the credit union provided the offer to the consumer. If a consumer responds more than 60 days after the offer is provided, then the credit union may NOT rely on its initial determination and must treat the consumer’s response to the offer as if the consumer is initiating the transaction or applying for credit and make a new determination of the consumer’s status.

e. Record Retention. A credit union must maintain a record of the information obtained to determine the borrower’s status. The Rule does not specify a retention period, however, the MLA provides a statute of limitations of five years. The credit union should consider maintaining a record for five years after the loan is paid or the account is closed.

f. Current Safe Harbor. A credit union may continue to use the safe harbor method for determination of the borrower’s status provided under the current rule until the mandatory compliance date for the new Rule.

IV. Required Disclosures.
a. Required Information. The credit union must provide a Covered Borrower with
   i. A statement of the MAPR
   ii. Disclosures required by Regulation Z “only in accordance with the requirements of
       Regulation Z that apply to that disclosure,” AND
   iii. A clear description of the payment obligation. The disclosures given in accordance with
       Regulation Z satisfy this requirement.

b. One-Time Delivery; Multiple Creditors. The statement of the MAPR and the description of the
   payment obligation are only required to be given once. If multiple creditors are involved in the
   transaction, only one of the creditors is required to provide the required disclosures.

c. Statement of the MAPR. The credit union is NOT required to describe the MAPR as a
   numerical value (percentage rate) or total amount of all charges. Rather, the credit union need
   only describe all the charges it may impose in connection with transaction necessary to
   calculate the MAPR. The credit union may, but is not required to, issue a separate disclosure
   (or form) for the statement of the MAPR, or may include the statement in the credit agreement
   for the transaction. The credit union is not required to include the statement of the MAPR in any
   advertisement. The Rule provides a model statement the credit union may use (see the model
   statement in the InForm section below). This statement may, as stated above, be issued
   separately, or incorporated into the credit union’s existing credit agreements.

d. Methods of Delivery. The statement of the MAPR and the description of the payment obligation
   must be provided BOTH in writing in a form the borrower can keep AND orally. The credit union
   may deliver the oral disclosures in person or by telephone. If disclosures are made by
   telephone, the credit union must provide a toll free number. The toll free number must be
   included on applications, and the statement of the MAPR and description of the payment
   obligation.

e. Refinancing or Renewal. The disclosures required by the Rule are required to be given when a
   transaction is considered a new transaction requiring disclosures under Regulation Z.

V. Prohibited Practices. The credit union may not extend a loan to a Covered Borrower in which
   a. The borrower is required to waive the right to legal recourse under applicable state or federal
      law, including the Servicemembers Civil Relief Act
   b. The borrower is required to submit to arbitration or onerous legal notice requirements in case of
      a dispute
   c. The credit union demands unreasonable notice from the borrower as a condition for legal action
   d. The borrower is required to establish an allotment to repay the obligation, OR
   e. The borrower is prohibited from prepaying the loan or charged a fee for prepaying all or part of
      the loan
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☐ Revise loan policies to reflect the requirements of the rule
☐ Revise procedures to comply with the requirements of the rule
☐ Establish procedures to determine whether an applicant is a “Covered Borrower” before extending a loan or extending a firm offer of credit
  ☐ Department of Defense database
  ☐ Credit bureau
  ☐ other
☐ Establish procedures for retaining any information used to determine whether an applicant is a “Covered Borrower”
☐ Train lending, audit, compliance and other appropriate staff on the requirements of the rule
☐ Determine how the credit union will provide the required disclosures
  ☐ Written disclosures
    ☐ Modify credit agreements, or
    ☐ Provide separate form
  ☐ Oral disclosures
    ☐ In person
    ☐ Identify responsible staff and provide training
    ☐ Establish procedures for documenting the verbal disclosure of the statement of the MAPR and the description of the payment obligation
  ☐ By telephone
    ☐ Ensure that a toll free number is available
    ☐ Include toll free number on the statement of MAPR and description of payment obligation
    ☐ Establish procedures for documenting the telephonic disclosure of the statement of the MAPR and the description of the payment obligation
☐ Establish procedures for calculating the MAPR for covered loans
☐ Make necessary changes to loan data processing systems to include fees and charges required to be included in the calculation of the MAPR under the rule including
  ☐ Credit insurance premiums or fees, debt cancellation contract charges, debt suspension agreement charges
  ☐ Fees for credit-related ancillary products
  ☐ Finance charges as defined by Regulation Z
  ☐ Application fees (except in connection with short-term, small amount loans charged not more than once in any rolling 12 month period)
  ☐ Participation fees except as permitted below
☐ For open-end loans
  ☐ NOT CREDIT CARD - Ensure loan data processing systems/processes do not allow any charge to be imposed during any billing cycle in which the account has a $-0- balance, EXCEPT a participation fee not in excess of $100
  ☐ CREDIT CARD - Ensure loan data processing systems/processes do not allow any charge to be imposed during any billing cycle in which the account has a $-0- balance, EXCEPT a bona fide participation fee
☐ Determine whether fees charged in connection with credit cards are “bona fide”
☐ Review agreements and practices to ensure that a borrower is NOT
☐ required to waive the right to legal recourse under any state or federal law, including SCRA
☐ required to submit to arbitration or onerous legal notice requirements in case of a dispute
☐ required to establish an allotment to repay the loan
☐ prohibited from, or charged a fee for, prepaying all or part of the loan

☐ Determine if warranty or indemnity is appropriate in connection with Covered Loans received by assignment (consult with legal counsel)

☐ Electronic Transactions – establish processes, procedures and systems to ensure electronic loan transactions comply with the requirements of the rule
  ☐ Determination of borrower’s status
  ☐ Delivery of required disclosures
ABC Credit Union
Lending Policy for Loans Subject to the
Military Lending Act (“MLA” or “the Act”) and
Department of Defense Rules

ABC Credit Union (“Credit Union”) will comply with all applicable federal and state laws regulations. More particularly, the Credit Union will comply with the requirements of the regulations issued by the Department of Defense (32 C.F.R. § 232.1 et seq. - “the Rule”) when extending consumer credit to a “Covered Borrower” (as that term is defined by the Rule). A loan to a Covered Borrower will not have a Military Annual Percentage Rate (“MAPR”) in excess of 36% calculated as prescribed by the Rule.

Determination of Coverage – Borrower Status
Before extending a loan subject to the Rule, ABC Credit Union will determine if an applicant for a Covered Loan is a “Covered Borrower” as that term is defined in the Rule. Except as provided below in connection with a firm offer of credit, such determination will be made at or thirty (30) days before the time an applicant becomes obligated on a “Consumer Credit” (as that term is defined by the Rule) transaction or establishes an account for Consumer Credit, or prior to extending a firm offer of credit. If a member responds to a firm offer of credit more than sixty (60) days after the offer is provided to the member, the Credit Union will make such determination again prior to extending Consumer Credit or establishing an account for Consumer Credit. It shall be the responsibility of [position(s) of staff member(s)] to determine if an applicant is a Covered Borrower. Such determination shall be made using [the Department of Defense database / information obtained from the applicant’s credit bureau / describe other method]. The Credit Union shall establish processes, procedures and systems to ensure such determination is made as provided herein. Except as required in connection with a firm offer of credit, the Credit Union will not perform the determination required by the Rule and this policy after the initial determination as provided above.

Loans Not Covered
The following loan types are not covered by the Rule and, therefore, are not subject to this policy:

- Any credit transaction secured by an interest in a dwelling (whether or not attached to real property)
- Any credit transaction intended for the purchase of a motor vehicle in which the vehicle purchased provides security for the credit transaction
- Any credit transaction intended for the purchase of personal property in which the personal property provides security for the credit transaction
• Any credit transaction that is exempt from the requirements of Regulation Z or otherwise exempt from the disclosure requirements of Regulation Z including, but not limited to, securities, business or agricultural, and public utilities credit.

Maximum MAPR for Covered Transactions
Loans to Covered Borrowers subject to this policy will not have an MAPR exceeding 36% calculated in accordance with the requirements of the Rule. The Credit Union will establish and maintain processes, procedures and systems for proper calculation of the MAPR. As part of these processes, procedures and systems, the Credit Union will evaluate the types and amounts of fees charged to Covered Borrowers to determine if such fees are “bona fide” as that term is defined by the Rule. The Credit Union [may / will not] charge non-bona fide fees. In addition, the Credit Union will determine whether fees charged in connection with credit card accounts are reasonable in accordance with the requirements of the Rule.

Required Disclosures
Covered Borrowers will be provided with the disclosures required by the Rule. Disclosures will be given to the Covered Borrower at the time the borrower becomes obligated on the transaction or establishes the account. All disclosures shall be given to the borrower in writing in a form the borrower can keep. The statement of the MAPR and the description of the payment schedule shall also be given to the borrower orally. Oral disclosures shall be [given in person / provided by telephone / in person and made available by telephone]. The written statement of the MAPR shall be [included in the credit agreement for the transaction / provided on a separate document]. [IF DISCLOSURES ARE PROVIDED TELEPHONICALLY: The Credit Union will establish and maintain processes, procedures and systems to ensure delivery of disclosures in accordance with this policy and the Rule.] The written description of the payment schedule shall be contained in the disclosures required by Regulation Z as authorized by the Rule.

Prohibited Acts or Practices
The Credit Union will not:
• Require a Covered Borrower to waive any right to legal recourse the Covered Borrower may have under any provision of state or federal law including the Servicemembers Civil Relief Act
• Require a Covered Borrower to submit to arbitration or impose onerous legal notice provisions in the case of a dispute
• Require unreasonable notice from a Covered Borrower as a condition for legal action
• Require a Covered Borrower to establish an allotment to repay the extension of credit
• Prohibit a Covered Borrower from prepaying all or a portion of the extension of credit or charge a penalty fee for prepaying all or a portion of the extension of credit.
Effective Date: October 1, 2015 – COMPLIANCE MANDATORY OCTOBER 3, 2016
32 CFR Part 232
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STATEMENT OF MILITARY ANNUAL PERCENTAGE RATE (“MAPR”)

Federal law provides important protections to members of the Armed Forces and their dependents relating to extensions of consumer credit. In general, the cost of consumer credit to a member of the Armed Forces and his or her dependent may not exceed an annual percentage rate of 36 percent. This rate must include, as applicable to the credit transaction or account: The costs associated with credit insurance premiums; fees for ancillary products sold in connection with the credit transaction; any application fee charged (other than certain application fees for specified credit transactions or accounts); and any participation fee charged (other than certain participation fees for a credit card account).