



CUNA and the Defense Credit Union Council will jointly sponsor an audio conference call to be held April 25th from 2-3:30 PM Eastern Time. The call will provide both an opportunity to learn more about this proposal and to voice your concerns regarding how these rules will impact credit unions.

April 11, 2007

DEFENSE DEPARTMENT ISSUES PROPOSED RULES TO IMPLEMENT THE NEW MILITARY LENDING LAW

- The Department of Defense (DoD) has issued proposed rules to implement the new military lending law that is intended to protect military servicemembers and their dependents from abusive lending practices. The new law, passed by Congress and signed by President Bush on October 16, 2006, imposes a number of restrictions with regard to loans for military personnel.
- The effective date for these requirements will be October 1, 2007 and will only apply to transactions consummated on or after that date. DoD anticipates publishing the final rules by September 1, 2007.
- The proposed rules indicate that the restrictions contained in the proposal will apply to payday loans, vehicle title loans, and tax refund anticipation loans, as those products are defined in the proposal. For these types of loans, the rules will impose limitations on the cost and terms and will require additional disclosures. Through the comment process, we will work to ensure that these restrictions will not inadvertently apply to other types of credit.
- The new proposal will require the cost of the covered transaction as a total dollar amount and as an annualized percentage rate to be disclosed, which is referred to as the Military Annual Percentage Rate (MAPR). The MAPR will differ from the annual percentage rate (APR) calculated under the Truth in Lending Act (TILA) since the MAPR will include fees that are not included in the TILA APR. The MAPR of credit covered under these rules must not exceed 36%.

- The rules impose a number of other restrictions, including a requirement to provide oral disclosures, although the rules provide some latitude for oral disclosures in connection with Internet and mail transactions.
- DoD's proposal states that the intent of the statute is to clearly apply these limitations so they impact negative credit practices without impeding the availability of credit that is benign or beneficial to servicemembers and their families. DoD has indicated that the products and services provided by credit unions have been helpful in its efforts to alleviate this problem.
- Comments on this proposal will be due by June 11, 2007.

Please submit your comments to CUNA by May 30, 2007. Please feel free to fax your responses to CUNA at 202-638-7052; e-mail them to Senior Vice President and Deputy General Counsel Mary Dunn at mdunn@cuna.com or to Senior Assistant General Counsel Jeff Bloch at jbloch@cuna.com; or mail them to Mary or Jeff in c/o CUNA's Regulatory Advocacy Department, 601 Pennsylvania Avenue, NW, South Building, 6th Floor, Washington, DC 20004. You may also contact us at 800-356-9655, ext. 6032, if you would like a copy of the proposed rules, or you may access them on the Internet at the following address:

<http://a257.g.akamaitech.net/7/257/2422/01jan20071800/edocket.access.gpo.gov/2007/pdf/07-1780.pdf>

BACKGROUND

Congress enacted a law last year that imposes a number of new restrictions with regard to loans for military personnel. This includes a 36% interest rate cap on certain loans extended to members of the military, reserves, the National Guard, as well as their dependents (exceptions include home loans and secured purchase-money loans for cars and other personal property). The law also includes a general prohibition on refinancing or consolidating these types of loans by the same creditor; prohibits holding checks, automated clearinghouse (ACH) authorizations, or vehicle titles as security for the loan; requires additional disclosures, including oral disclosures, and imposes a number of other restrictions. DOD is responsible for issuing the rules to implement the law, in consultation with NCUA and the other financial institution regulators.

BRIEF DESCRIPTION OF THE PROPOSAL

Types of Credit that are Covered Under the Proposal

The proposed rules will apply to credit unions, as well as all other creditors, and will apply to the following types of credit:

- Payday loans - defined as “closed-end” credit with a term of 91 days in which the amount financed is no more than \$2,000. (Closed-end credit is generally defined as credit that is not open-ended, such as credit cards.) To be considered a payday loan the borrower must either:
 - Receive funds and incur interest or charged a fee by the creditor, while at the same time provide a check or other payment instrument to the creditor, who agrees not to deposit the check for more than one day.
 - Receive funds and incur interest or charged a fee by the creditor, while at the same time authorizing the creditor to initiate a debit to the borrower’s deposit account after at least one day. This will not affect a financial institution’s right under other law to offset indebtedness against funds on deposit in the event of the borrower’s delinquency.
- Vehicle title loans – defined as closed-end credit with a term of 181 days or less that is secured by the title to a motor vehicle owned by the borrower, other than when the borrower provides title as part of the transaction to purchase the vehicle.
- Tax refund anticipation loans – defined as closed-end credit in which the borrower gives the creditor the right to receive all or part of the borrower’s income tax refund or agrees to repay the loan with the proceeds of the refund.

The statute enacted last year excludes residential mortgages from these requirements. The proposed rules clarify that this exception includes mortgages on homes in addition to the primary home, mortgage refinance transactions, home equity loans and lines of credit, and reverse mortgages. The proposal also specifically excludes the purchase of personal property when the credit is secured by the property being purchased, credit secured by a qualified retirement account as defined in the Internal Revenue Code, as well as any other credit that is not considered consumer credit or otherwise subject to the TILA disclosure requirements. Although not specifically mentioned, it would appear that all other types of credit, other than payday loans, vehicle title loans, and tax refund anticipation loans, would also be excluded. CUNA will request clarification of this through the comment process.

Borrowers Covered Under the Proposal

The proposed rules also define those borrowers who would be covered under this new law. This would include any regular or reserve member of the Army, Navy, Marines, Air Force, or Coast Guard who is serving on active duty under a call or order that does not specify a period of thirty days or less, or such member is serving on Active Guard or Reserve duty, such as those serving on active or full-time National Guard duties. Covered borrowers would also include the borrower’s spouse, children (if they are less than 18 years of age, or 23 years of age if attending school, or if disabled before the age of 18), or other individuals in which the borrower provides more than one-half of his or her support for 180 days immediately before the extension of the credit.

The 36% MAPR Limitation

As required under the statute enacted last year, the proposal prohibits a creditor from imposing an MAPR that exceeds 36%. Again, this would apply to payday loans, vehicle title loans, and refund anticipation loans.

The MAPR will differ from the APR that is calculated under TILA in that the MAPR includes more fees within the calculation, such as credit service charges, credit renewal charges, credit insurance premiums, fees for debt cancellation or debt suspension agreements, and fees for credit related products sold in connection with the consummation of the transaction. The MAPR will not include a fee imposed for unanticipated late payments, defaults, delinquency, or similar occurrences.

Identification of the Servicemember of Dependent who is Covered Under the Proposal

The proposal provides a “safe harbor” process for identifying servicemembers or their dependents who may be eligible for the protections under these rules. Under this process, the creditor will not be subject to the requirements of this proposal if the following requirements are met:

- Before entering into the transaction, the applicant is provided a “covered borrower identification statement” that is clear and conspicuous in which the applicant signs to indicate whether he or she is covered under these protections. The proposal includes a model statement that creditors may use for this purpose.
- The creditor has not determined through an optional verification process that the applicant would be covered under this proposal.

As for the optional verification process, creditors are permitted, but not required, to verify the military status of the applicant by requiring a military leave and earnings statement, or a military identification card. Upon such a request, activated members of the National Guard or Reserves must also provide a copy of the military orders that calls the individual to active duty or further extends the active duty. The creditor may also verify status by accessing this information on the Internet at <https://www.dmcddc.ods.mil/scra/owa/home>.

Additional Disclosures

For any credit that is covered under the proposed rules, the creditor must provide the following disclosures to the servicemember or dependent, which must be clear and conspicuous and provided prior to the consummation of the transaction:

- The MAPR and the total dollar amount of the charges included within the MAPR.
- The disclosures required under TILA/Regulation Z.

- A description of the payment obligation of the borrower. A payment schedule provided pursuant to Regulation Z will be sufficient.
- A statement that “Federal law provides important protections to active duty members of the Armed Forces and their dependents. Members of the Armed Forces and their dependents may be able to obtain financial assistance from Army Emergency Relief, Navy and Marine Corps Relief Society, the Air Force Aid Society, or Coast Guard Mutual Air. Members of the Armed Forces and their dependents may request free legal advice regarding an application for credit from a service legal assistance office or financial counseling from a consumer credit counselor.”

The disclosures must be in writing and must also be provided orally. For mail and Internet transactions, the creditor may comply with the oral disclosure requirement by providing a toll-free telephone number with the written disclosures that the borrower may use to obtain oral disclosures. The creditor must then provide the oral disclosures when the borrower contacts the creditor for this purpose.

Preemption

The statute as implemented by these rules will preempt any inconsistent State or Federal law or rule, unless it provides additional protections to borrowers beyond those provided by the statute and these rules. A State may also not charge MAPRs that are higher than the limit for the residents of the State, or permit the violation or waiver of any State consumer lending protection that is for the benefit of the residents of that State, solely on the basis of the borrower’s nonresident or military status.

Additional Limitations

Assignees of the creditor are also required to comply with these rules. The proposal also outlines the following additional prohibitions for creditors and their assignees:

- The creditor may not roll over, renew, repay, refinance, or consolidate any credit extended to the servicemember or dependent that was previously extended by the same creditor, unless the new transaction is more favorable to the borrower, such as a lower MAPR.
- The borrower may not be required to waive his or her rights under any other State or Federal law, including the Servicemembers Civil Relief Act (SCRA).
- The creditor may not require the borrower to submit to arbitration or impose other onerous legal notice provisions if there is a dispute.
- The creditor may not demand unreasonable notice from the borrower as a condition for legal action.
- The creditor may not use a check or other method of access to an account maintained by the borrower, or use the title of a vehicle as security for the obligation. However, the creditor may:

- Require an electronic fund transfer to repay the debt, unless otherwise prohibited by Regulation E, the Electronic Fund Transfers Act.
- Require direct deposit of the borrower's salary, unless otherwise prohibited by law.
- Take a security interest in the funds that are deposited after the extension of credit in an account established in connection with the transaction.
- The creditor may not require that the borrower establish an allotment to repay the obligation.
- The creditor may not prohibit the borrower from prepaying the debt or charge a fee for prepaying all or part of the debt.

Penalties and Remedies

Violations of these rules are punishable by fines and imprisonment of not more than one year. These are in addition to the relief available to the borrower under any other law.

Also, any credit agreement, promissory note, or other contract that does not comply with these rules will be void from the inception of the contract. Arbitration agreements in connection with credit that is covered under these rules will not be enforceable. These rules will also not limit the provisions of the SCRA.

Effective Date

These rules will apply to credit that is consummated on or after October 1, 2007.

**QUESTIONS TO CONSIDER REGARDING THE PROPOSED RULES TO IMPLEMENT THE NEW MILITARY LENDING LAW
(DoD has specifically requested comment on these issues)**

- Should these rules completely exclude credit unions, banks and thrifts? Instead should they be excluded in limited circumstances, such as when: 1) the institution is subject to supervision and regulation by a federal agency; 2) the extension of credit is subject to guidance by a financial institution on agency that addresses consumer protection, disclosure, and safety and soundness criteria; and 3) the financial institution agency agrees to act on matters referred to it by DoD regarding complaints that the lending covered under these rules is inconsistent with supervisory guidance, applicable law, or is having an adverse affect on military readiness?



- Does the 91-day or \$2000 limit for payday loans under these rules create any unintended consequences for other credit products?

- Does the 181-day limit for vehicle title loans under these rules create unintended consequences for other credit products?

- Are there other regulatory approaches that would encourage creditors to offer affordable small-dollar, short-term loans to servicemembers and their dependents? For example should payday loans that would be covered under these loans be excluded if the MAPR is under 24% or some other level? Would a similar rule be appropriate for vehicle title and tax refund anticipation loans? Are there other approaches that should be considered?

- Besides fees for unanticipated late payments, defaults or delinquencies, are there other fees that should be excluded from the MAPR for similar reasons?

- What is the creditor's involvement in the tax filing aspects of a refund anticipation loan?

- Do you have comments regarding the “safe harbor” approach regarding servicemember identification, in which the creditor may rely on a statement signed by the applicant indicating whether he or she is covered these rules, assuming additional information does not surface to indicate otherwise?
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- The rules allow flexibility with regard to providing oral disclosures in connection with telephone and Internet transactions. Under these circumstances, the creditor would only be required to provide a toll-free telephone number in which the applicant may call to receive these oral disclosures. Does this adequately address the compliance concerns with regard to providing oral disclosures under these circumstances? Is there a better approach?
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- DoD recognizes the confusion with regard to providing both an MAPR and the APR, as required under TILA. What comments do you have on this requirement and do you have suggestions for an alternative approach?
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- The rules will prohibit a creditor from renewing or refinancing credit previously extended by that same creditor but provides an exception if there is a benefit to the borrower. Do you agree with this approach? Should the rules be clarified so that such refinancings and renewals require new disclosures only when the transaction would also be considered a new transaction that requires TILA disclosures?
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- For refinancings and renewals, the rules will not apply if the borrower is a covered servicemember at the time of a refinancing or renewal but was not a covered servicemember at the time the original loan was made. Do you agree with this approach? If this is changed so that the rules would apply under these circumstances, should the rules be clarified so that such refinancings and renewals require new disclosures only when the transaction would also be considered a new transaction that requires TILA disclosures?
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- The rules will prohibit a creditor from requiring the borrower to submit to arbitration or impose other “onerous legal notice provisions.” Do you know of any legal notice provisions that should be considered “onerous?”
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- The rules will also prohibit a creditor from demanding “unreasonable notice” from the covered borrower as a condition for legal action. Do you know of any particular notice requirements that should be considered “unreasonable?”
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- The rules provide an exemption to creditors that will allow the use of an electronic fund transfer to repay the loan, require a direct deposit of the borrower’s salary, or take a security interest in the funds deposited after the extension of credit in an account established in connection with the loan. Do you agree with this approach?
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- The rules will prohibit prepayment penalties. Do you agree with this approach?
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- Do you have suggestions as to how these rules can be enforced with respect to creditors that are not regulated by a financial institution regulator? Will private litigation and criminal penalties be sufficient in these situations?

- DoD intends to issue the final version of these rules by September 1, 2007, which will then become effective on October 1, 2007. Will this allow sufficient time for compliance, considering that the rules will only apply to payday loans, vehicle title loans, and tax refund anticipation loans?

- Other comments?
