

Section 3 – The Servicemembers Civil Relief Act

revision

Background and Purpose

Congress enacted the Soldiers' and Sailors' Civil Relief Act (SSCRA) in 1940 to protect the interests of our national defense by limiting the financial obligations of certain individuals in military service during their period of active duty with the U.S. Armed Forces. The Act did not relieve the obligations of an active duty servicemember to repay his or her debts. However, it did recognize that the ability of some individuals to repay loans would be lessened as a result of going on active duty. Such individuals were deemed to be "materially affected" because of their reduced financial circumstances, and were required to pay only 6% interest on obligations incurred prior to active duty. In addition to the interest rate provisions, the Act severely restricted the ability of credit unions to obtain a default judgment against a servicemember whose ability to defend himself in court had been prejudiced by active duty status.

In December of 2003, President George W. Bush signed the Servicemembers Civil Relief Act (SCRA) into law to "restate, clarify, and revise" the SSCRA. The SCRA clarifies the language of the SSCRA and incorporates the many years of judicial interpretation of the 1940 statute. Although the Act is quite technical, Congress did not direct a federal regulator to develop rules or guidelines with which lenders must comply. Therefore, even with the updated language, there may still be legal issues regarding the law's implementation that may need to be resolved.

The provisions regarding the interest-rate limit and default judgment remain two of the key provisions in the Act, but there are many others with which credit unions must comply. The SCRA requires that the military instruct servicemembers as to their rights under the statute, and these individuals will be well aware of what protection is due them.

Therefore, in order to assist the servicemember and to protect the credit union's own financial interests, credit union compliance officers should have a thorough understanding of creditors' rights and restrictions under the law.

Key Terms

An understanding of the following key terms is essential to determining how the statute affects the operations at your credit union. The subsequent information in this module will be more meaningful if you take a look at all of the descriptions of key terms prior to reading the rest of the manual.

Active Duty. Individuals who are on full-time duty in the active military service of the U.S. For example, when an individual enlists and receives orders to report for basic training, he or she is on active duty. In this module, the terms, "active duty" and "military service" are used interchangeably.

Active duty personnel includes individuals appointed, enlisted, or inducted into the regular branches of the U.S. military service, i.e., Army, Air Force, Navy, Marines, and Coast Guard, as well as personnel mobilized in National Guard and Reserve Units, and commissioned officers of the Public Health Service or the National Oceanic and Atmospheric Administration. "Active duty" also includes full-time training (e.g., boot camp, advanced training, etc.) for active military service at a school designated by law or by the secretary of the military department concerned as a military service school.

Under the 1940 statute, the law applied only to members of the National Guard that were mobilized into federal service under Title 10 of the United States Code. The Veterans Benefits Act of 2002 changed this and extended the Act's protection to National Guard members called to state active duty under Title 32, if: (1) the duty was because of a federal emergency; (2) the request for active duty was made by the president or Secretary of Defense; and (3) the member was activated longer than 30 days. Congress incorporated this provision into the language of the SCRA of 2003.

The Act is designed to protect certain individuals who, as civilians or reservists, enter or are mobilized into active duty. Therefore, the Act does not cover retired personnel not on active duty or those in a reserve unit not on active duty. Several state courts have ruled that career military personnel are also excluded from the protections of the Act when their financial positions have not been "materially affected" by military service (see description of this term below).

Materially Affected. The protections of the Act extend to those individuals on active duty who are "materially affected" as a result of active duty status. Generally, the Act protects against two kinds of material effects:

- one material effect is that a servicemember on active duty is unable to protect legal rights, for example, by not being able to appear in court.
- the second material effect is that he or she is unable to meet prior financial obligations because for example, the member suffers a cut in pay on active duty. In some cases, the servicemember will face both kinds of material effects.

In judicial disputes as to whether the Act applies and to what extent, the court will determine if the servicemember has been materially affected as a result of going on active duty.

Military Service. Men and women who are appointed to or have enlisted in one of the branches of the federal military, i.e., the Army, Navy, Air Force, Marines, or Coast Guard. The period of military service begins when the servicemember receives his or her orders to report for active duty. Generally, it ends with the date of termination from active duty or upon death while in active service. Military service includes the time period during which a servicemember is absent from duty because of sickness, wounds, leave or other lawful cause.

Mobilization. The act of ordering National Guard and Reserve Units to active duty.

Servicemember. Means a member of the uniformed services, which includes the United States Army, Navy, Air Force, Marine Corps, Coast Guard, the commissioned corps of the National Oceanic and Atmospheric Administration, and the commissioned corps of the Public Health Service.

General Provisions

Coverage under the SCRA

The statute sets up three “tests” that must be met in order for an individual to be protected.

First, an individual must be in military service of the U.S. For purposes of the SCRA, persons in the military service, whether male or female, include appointed or enlisted members of the: Army, Navy, Marine Corps, Air Force, Coast Guard, active Reserve Units, certain National Guard Units, and Commissioned Officers of the Public Health Service and National Oceanic and Atmospheric Administration. In addition, individuals who are ordered to report for training or education, if such schooling is performed under the complete supervision of the U.S., are considered to be persons in military service for purposes of the Act.

U.S. citizens who serve with the forces of a nation allied with the U.S. “in the prosecution of a war or military action” may also be protected under the Act if the service with the allied force is similar to military service covered by the SCRA. Relief and protections terminate on the date of individual’s discharge or release from service.

Further, the protections of the Act may also extend to dependents of service persons, as well as to individuals who are secondarily liable for obligations owed by military members. How dependents and others are affected by the Act is addressed further on in this module.

Second, the servicemember must be on active duty. This means full-time duty and for example, includes members of a reserve unit that is mobilized, as well as members of the branches of the regular military. Courts have held that active duty does not encompass a retired person not on active duty or members of a reserve unit not on active duty.

The period of active duty begins when an individual receives his or her orders to report for duty or for full-time training, such as boot camp. Active duty ends with the date of discharge or upon death in active duty. As discussed in subsequent sections of this module, some of the protections of the Act extend beyond the individual’s separation from the military.

When the U.S. is at war, an individual’s period of active duty can extend for as long as the military deems appropriate. Generally, this would be no longer than two years. When the U.S. is not at war, the president may mobilize reserve troops under the War Powers Act. In that situation, the time period for an individual’s active duty is generally limited to a total of 180 days — an original period of 90 days, which may be extended one time under the Act for another 90 days.

Third, the servicemember must be “materially affected” or disadvantaged as a result of going on active duty. In general, a servicemember may be materially affected in two ways. One is that he or she is unable to take full advantage of legal rights, for example by not being able to appear in court to defend personal interests. A second way a servicemember may be materially affected or harmed is that he or she may be unable to meet financial obligations incurred prior to active duty because, for example, of a reduction in pay.

Three-part coverage test

The easiest way to remember who is covered by the SCRA is to break the required elements down into a three-part test. Ask whether the member is:

1. In the military service of the U.S.,
 2. On active duty, and
 3. Materially affected as a result of active duty status.
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Servicemembers are informed of their rights under the Act

The Act requires the military to give notice of the benefits of the statute to persons in and entering military service. The Defense Department has prepared a detailed pamphlet which is available to every military member who enters service. Individual branches of the military have also prepared various publications to assist military members who are mobilized, and these materials include information on benefits under the Act. In addition, during military training, servicemembers are given instruction on the provisions of the Act. This means that active-duty military personnel should be aware of their rights under the Act and of the limits the Act places upon creditors. Credit unions and other lenders will want to make sure they are also well-informed about what the Act provides for servicemembers and requires of creditors.

Jurisdiction of courts to hear disputes under the Act

Proceedings under the Act may be initiated in any competent federal or state court in which no proceeding has already commenced with respect to a matter. This includes courts such as small claims courts which may not be of record.

Modification of agreements and waiver of benefits

Section 107 of the SCRA permits a servicemember to waive any of the rights and protections provided by the Act. Parties may mutually agree to modify or terminate any contract, lease, bailment or obligation secured by a mortgage, trust, deed, lien, or other security in the nature of a mortgage. Section 107 also provides that the creditor may repossess, retain, foreclose, sell or take possession of property which is security for an agreement that was executed during or after the period of active duty.

The Act requires that the servicemember's waiver be made pursuant to a written agreement of the parties that is executed during or after the servicemember's period of military service. Needless to say, the modification must be signed by the borrower and must be the result of the good faith dealing of both parties.

Following a review of the servicemember's financial status, the credit union and servicemember may determine that the loan agreement should be modified. Such modification will enable the credit union to continue collecting payments without judicial intervention and, depending on the contract as modified, may permit the creditor to charge more than 6% interest that would otherwise apply to debts incurred by servicemembers prior to active duty.

Some creditors would prefer to apply the 6% interest rate by reducing the number of payments due, rather than require a lesser payment during the period

of active duty. However, this action would be contrary to Section 207 of the SCRA, which requires that amount of the periodic payment be reduced by the amount of the interest (in excess of 6%) that is forgiven that is allocable to the period for which such payment is made.

However, the servicemember and the creditor could enter into a loan modification agreement in which the contract interest rate would continue to apply throughout the remaining term of the loan, even the active duty period, but the number of payments due would be reduced to reflect the 6% interest rate that applied during active duty. Credit unions may not take such action unilaterally — only after the original contract has been renegotiated and agreed to by both parties may a creditor reduce the number of payments due, rather than require lesser payments during the active duty period.

It is also important to remember that even if a servicemember may renegotiate loan agreements, it does not mean that he or she waives all other rights under the Act, such as the right to have court proceedings stayed or vacated.

Transfers of interests to take advantage of the Act

Debtors who are ineligible to receive the protections of the Act may not transfer or assign any interest, property or contract to individuals covered by the Act for the purpose of coming under the statute.

Defenses financial institutions might raise in SCRA disputes

The fact that an individual is not in military service, is not on active duty, is not materially affected by active-duty status, or is involved in a transfer of interests to take advantage of the Act, are claims or defenses financial institutions might be able to raise in litigation under the Act, depending on the facts of the particular case. It appears the burdens of proof and evidentiary requirements for these claims or defenses vary depending on the jurisdiction in which the case is brought. Issues relating to the burdens of proof are addressed in subsequent sections of this section in connection with specific remedies afforded to servicemembers under the Act.

General Relief Provisions for Servicemembers: Default Judgments, Stay of Proceedings and Execution of Judgments

Default judgment against an active-duty servicemember

If, for example, a servicemember has a loan agreement with a creditor and has failed to make repayment on the loan as called for in the contract, the creditor is not precluded from taking action in court to seek what is owed under the contract. If the servicemember is able to appear in court either in person or through his or her chosen representative, the provisions of Title II regarding default judgments will not have effect. However, if the servicemember is unable to appear, the Act severely restricts a creditor's ability to obtain a default judgment against the member.

The Act provides that in any action or proceeding in any court in which the defendant (i.e., the servicemember) does not make "any appearance," the plaintiff (i.e., the creditor) before obtaining a default judgment must file an affidavit stating facts showing that the defendant is not in military service. The affidavit requirement may be satisfied by a written statement, declaration, verification, or certificate that is subscribed and certified or declared to be true under penalty of perjury. If the statement is not filed, the judgment is voidable, i.e., it can be set aside and reopened by the servicemember "upon proper showing that he has been prejudiced by reason of his military service in making defense." The court may also require the creditor-plaintiff to file a bond to protect the defendant against loss should the judgment be set aside at a later date.

The affidavit must contain more than a mere recitation that the individual is not in military service. Facts supporting the statement must be included. If the defendant is in military service, the statement should state this fact. On the other hand, if after good faith efforts (e.g., searching military personnel bureaus in Washington, DC) the credit union is unable to determine whether the individual is in military service, the statement should indicate this fact. Any person who makes or uses an affidavit that he or she knows to be false may face a fine and/or imprisonment for not more than one year.

If the credit union fails to file the affidavit, the default judgment will not be entered against the servicemember unless the court orders it after an attorney has been appointed to represent the servicemember's interests, and a determination is made whether the defendant is in the military. The appointment of an attorney to represent the military member's interest is a mandatory requirement, but only when the member has not appointed his or her own attorney.

Reopening a default judgment

The Act provides that a servicemember may have a default judgment rendered against him or her reopened if the judgment was entered during service or within 60 days after separation from service. The servicemember must apply to the same court that rendered the judgment, and must file within 90 days after his or her military service ends.

The servicemember must not have made “an appearance” in the initial proceedings, for example, including a limited appearance such as filing a document to question the court’s jurisdiction, and must be able to demonstrate to the court that when the judgment was entered, the member was prejudiced in his ability to defend himself as a result of military duty. Further, the servicemember must be able to show the court that he or she has a legal defense to the original claim made by the plaintiff.

Setting aside the default judgment will not impair the rights or title to property involved in a case which has been subsequently acquired by a bona fide purchaser for value. Thus, if in following a default judgment involving a loan secured by an automobile, the Court allowed the creditor to repossess the car, and it was resold to a bona fide purchaser, the defendant would be unable to reclaim the car but rather would be able to seek money damages against the creditor.

Stay of proceedings, stay of executions

The Act includes several provisions which allow servicemembers to apply to the Court to stay proceedings or executions of judgments or attachments. These provisions also allow the Court on its own motion to order such stays. Under Section 202, a servicemember during service or within 90 days of separation who is involved in a civil proceeding as either the plaintiff or defendant may request the court to stay the proceeding at any stage before final judgment is rendered.

Unlike some other provisions in the Act that also allow servicemembers to seek a stay, this provision applies to obligations incurred prior to service as well as those incurred during military service.

The servicemember must present evidence which demonstrates that military service has materially affected his ability to take legal action or defend the action in which he is involved. An application for a stay must include:

- 1) a letter or other communication that explains the manner in which current military duty requirements materially affect the servicemember’s ability to appear, and stating a date when the servicemember will be available to appear; and
- 2) a letter or other communication from the servicemember’s commanding officer stating that the servicemember’s current military duty prevents appearance and that the military leave is not authorized at the time of the letter.

The servicemember may apply for an additional stay based on continuing material affect of military duty on the ability to appear in court either with the initial application, or at a later date if it appears that the servicemember will not be able to prosecute or defend the action.

The court is directed to grant the stay unless it determines that the ability of the servicemember to pursue legal rights and remedies is not materially affected by military service. The court under this provision may stay the proceedings even if the member has not requested it, if the court is aware that a servicemember's legal rights are materially affected, i.e., prejudiced as a result of military service.

Section 204 of the SCRA provides for staying the execution of a judgment and vacating any attachment or garnishment of the servicemember's property in any proceeding against a person in military service or within 90 days of separation.

Length of stays

Under Section 205 of the Act, a court may stay a proceeding or execution of judgment for up to the period of the member's military service and 90 days after separation from service, or for any part of that period. It is within the court's discretion to determine the length of the stay, up to the maximum period permitted by the Act. This provision applies unless a provision of the Act granting specific relief expressly includes the maximum time permitted for the duration of a stay.

Fines and penalties on contracts

Section 203 provides that when an action for compliance with the terms of a contract is stayed, the servicemember may not be charged a fine or penalty for failure to comply with the agreement during the period of the stay. Also, if a stay does not exist, the court may nonetheless relieve the enforcement of a fine for nonperformance if the individual was in the military at the time the penalty accrued and his or her ability to pay was materially affected.

Statute of limitations

The statute of limitations, for example, the time period in which a legal claim must be made, is suspended during the period of military service of any military plaintiff or defendant, even if the claim arose prior to or during service. This provision is found at Section 206 of the SCRA. It means that if a cause of action, such as failure to make payments under a loan agreement, has a two-year statute of limitations, the period of a member's military service will not be included for purposes of computing the two-year term. The provision also states that a military member's length of service will be added to the time period allowed by law for the

redemption of real estate (paying off the mortgage and reclaiming the property) following foreclosure.

The provision regarding the statute of limitations is a two-edged sword. While it extends the period in which a creditor may pursue legal remedies against the servicemember, it also extends the time in which the servicemember may bring an action against the creditor.

Interest Rate Limitations

Under Section 207 of the SCRA, as soon as an individual goes on active duty (or receives orders to report for active duty), that person should be charged no more than 6 percent interest on obligations incurred *prior* to active duty. Prior joint obligations that involve the servicemember and his/her spouse would also receive the 6% rate. Therefore, outstanding balances on lines of credit taken out prior to active duty, including credit card lending, home equity lines of credit, home mortgages, car loans, share secured loans, and signature loans will be subject to a 6 percent interest rate during the active duty period.

The credit union must forgive any interest in excess of 6 percent that would have been incurred by the member if no rate cap was in effect. The term “interest” includes service charges, renewal fees, or any other charges (except bona fide insurance) with respect to an obligation or liability. In addition, Section 207(a)(3) of the SCRA requires credit unions to reduce “the amount of any periodic payment due from a servicemember ... by the amount of the interest forgiven ... that is allocable to the period for which the payment is made.”

The 6 percent interest rate limit does not apply to new advances under an existing credit card or home equity line of credit program. The statute requires the reduced rate only for obligations incurred prior to active duty. The servicemember is not entitled to the reduced rate for debt incurred during or after active duty, which would include advances on open end plans. This is true even if the open-end plan were established for the member prior to active duty.

In addition, the rate limitation does not apply to loans granted under the Guaranteed Student Loan Program. The Higher Education Act states that no provision of any law which limits the interest rates on a loan shall apply to the Guaranteed Student Loan Program. However, while active duty members are not entitled to a 6 percent interest rate on guaranteed student loans, they may defer their guaranteed student loan payments. Under Education Department regulations, any person who is serving a period of full-time active duty service in the military is eligible to receive a deferment of student loan payments. While such a deferment is in effect, the borrower does not have to make interest or principal payments and the interest does not accrue. The Education Department will pay the deferred interest to the owner or servicer of the loan. Credit unions

who grant loans under the Guaranteed Student Loan Program should contact the Department of Education in Washington, D.C., or one of its regional offices for more information.

How the 6 percent interest rate limit applies to fees

For closed-end loans, it is clear that the rate limitation applies to all fees, service charges, renewal charges or any other charges except for bona fide insurance. Thus, if a creditor charges the full 6%, it may not charge other fees, including a late fee, during the servicemember's period of active-duty.

How the 6 percent rate limit affects fees for open-end obligations is not as cut and dried. In trying to sort out how fees will be affected, it is useful to determine whether fees are related to specific transactions.

It appears that if a fee is related to new advances taken while the servicemember is on active-duty, the fee may be added to the account balance. Fees that relate to the outstanding balance prior to active-duty and that have not been paid when active-duty begins may not be added to the account. If such fees have already been billed, they should be removed from the account.

It is unclear whether some fees that are not related to specific transactions and that might come due during active-duty, such as a renewal or annual fee, are to be included within the 6% rate limit. The more conservative approach would be to include such fees within the 6 percent limit because they apply to the account as a whole. However, there may be data processing problems because the renewal fee may be shown on the account statement as part of new advances, to which the 6 percent rate limit does not apply.

Another reasonable view is that because the renewal fee will be imposed during active-duty, it may be added to the account as an obligation incurred while the servicemember is on active-duty.

Thus, there is no definitive answer on whether certain fees for open-end plans, such as renewal fees that come due during active-duty are subject to the 6 percent rate limit. Credit unions should discuss this and similar issues with their data processors and attorneys.

What must a servicemember covered by the SCRA do to receive reduced rates?

The 1940 statute did not require the servicemember to do anything to receive the 6% interest rate — active duty status alone triggered the rate reduction. The SCRA of 2003, however, requires the servicemember to provide creditors with a written notice and a copy of the military orders calling the servicemember to active duty, as well as any orders further extending military service. The notice must be provided not later than 180 days after the date of the servicemember's termination

or release from military service. Once the credit union receives this notice, it must reduce the interest rate on any preservice debt as of the date on which the servicemember was called to military service.

What if the credit union thinks a member is not entitled to a rate reduction?

If a credit union thinks a service member is not entitled to the rate reduction it may not automatically refuse to lower the rate. Only by going into court and proving that the ability of the servicemember to repay borrowings has not been materially affected by active duty may a creditor be released from the rate reduction. Also, during the court proceedings a credit union may be able to show that a servicemember may be able to pay more than 6%, even if he is unable to pay the full contract rate while on active duty.

Suspension of payments

Just as the credit union may not refuse to lower the interest rate, a servicemember may not suspend payments without court approval. If a servicemember is having difficulty making loan repayments (even with the 6% rate), he or she may petition the court to suspend or reduce payments. If the servicemember is being sued for repayment of an obligation, the court may authorize suspended or reduced payments.

The credit union and the servicemember may **renegotiate the original loan contract** and if they do, the interest rate may be higher than 6%. The Act provides that contracts may be modified, terminated or cancelled, and that property which is security for an obligation may be repossessed, foreclosed, sold or forfeited pursuant to a written agreement between the creditor and the servicemember entered into during or after the period of active duty.

If the loan agreement is not modified, the credit union may not avoid reducing the rate to 6% on obligations the servicemember entered into prior to active duty without authority from the court. As stated above, this is true even if a credit union believes a servicemember is not materially affected by military duty.

How to compute the 6% interest rate

Questions have also arisen as to how the 6% interest rate is to be computed. There is no guidance from the Act but based on federal case law, it would be reasonable to assume that creditors should use a simple interest rate.

Reinstating the original contract rate

The contract rate on the outstanding balance prior to active duty may be reinstated as soon as the servicemember is no longer on active duty. By reviewing the member's military orders, the credit union will have a pretty accurate picture of when the member will be discharged. The credit union should change the contract rate at the time indicated for discharge by the orders, even if the lender does not receive actual notice of the discharge until a later date. The credit union may have to adjust the account balance at a later time, depending on the actual date of discharge.

SCRA interest rate limitation:

- Applies when a servicemember goes on active duty, or receives orders to report for active duty.
 - Entitle a servicemember to a 6% interest rate on obligations incurred prior to active duty.
 - Also entitles joint obligations incurred prior to active duty to the rate limitation.
 - Includes outstanding balances on:
 - Credit cards; home equity lines of credit (HELOCs); home mortgages; car loans; share-secured loans; and signature loans.
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Truth-in-Lending Act Implications

This section discusses the Truth In Lending Act (TILA) requirements of Regulation Z that are triggered by compliance with the 6 percent interest rate reduction of the Act. This information is not intended to provide an in-depth discussion of Regulation Z requirements, but is included to draw creditors' attention to TILA concerns associated with compliance with the SCRA. Credit unions that have TILA problems based on specific situations should discuss them with an attorney and data processor who have expertise in the TILA and Regulation Z.

Change-in-terms requirements for open-end credit

Under Regulation Z, which implements the Truth In Lending Act, disclosure requirements vary depending on whether the loan is an open-end loan such as a home equity line of credit, or a closed-end loan, such as a 30-year home mortgage loan. For open-end credit, the 6 percent interest rate will trigger change-in-terms

notice requirements, but only when the rate on the outstanding balance incurred prior to active duty returns to the original contract rate.

Under Sec. 226.9(c) of Regulation Z, change-in-terms requirements apply to open-end obligations, including credit card borrowing and home equity lines of credit. However, when the rate on the outstanding balance (prior to active duty) goes down to 6 percent, a change-in-terms notice is not required. That is because this Section of Regulation Z explicitly exempts rate reductions in open-end plans from such notice requirements.

Change-in-terms requirements must be met for open-end plans when the member is no longer on active duty and the rate on the outstanding balance incurred prior to active duty returns to the contract rate.

Thus, not less than 15 days prior to the rate increase, the creditor must provide a written notice to affected servicemembers. The notice must be given to each member affected. (Please be aware that state law may require a longer change-in-terms notice period. Check with your state credit union league for details.)

A staff attorney for the Federal Reserve Board has indicated that when a creditor learns of or receives notice of an individual's active duty, it may provide the change-in-terms notice at that time. The notice should state that the rate will be increased to the original rate upon discharge of the servicemember from active duty.

Because the 6 percent interest limit does not apply to new advances, the rate for new advances never changes and change-in-terms notices do not have to be provided prior to charging the contract rate for new advances made while the servicemember is on active duty.

Changing the rate on outstanding balances for home equity lines of credit does not conflict with Regulation Z. Under Regulation Z, the annual percentage rate (APR) on a home equity line of credit may be changed only if it fits one of the categories of permissible changes. Reducing the rate to 6% on outstanding balances would be considered to be a beneficial change under Sec. 226.5b(f)(3)(iv). Increasing the APR back to the original contract rate will also be permissible under this same Section. The Federal Reserve Board's commentary to this section of Regulation Z states that lenders may temporarily reduce rates and then return the rate to the original level.

Review substantive limits on open-end home equity plans

Regulation Z basically regulates disclosure of credit terms for all types of credit. However, there are some substantive limits on open-end home equity plans, which do not apply to other credit arrangements. Credit unions that offer home equity lines of credit may want to review these provisions to get a better understanding of their options for handling problems which might arise as a result of a military member's active duty.

Section 226.5b(f) provides that a credit union may not terminate a plan and demand repayment of the outstanding balance unless:

1. There is fraud or material misrepresentation by the member in connection with the plan.
2. Any action or inaction by the member adversely affects the credit union's security for the loan.
3. The member fails to meet the repayment terms of the agreement for any outstanding balance.

The fact that the servicemember is paying interest at a rate of 6% on outstanding home equity balances rather than the original contract rate does not constitute a failure to meet repayment terms for purposes of Regulation Z. Thus, the credit union may not terminate the plan and require payment of the outstanding balance simply because the active duty servicemember is paying 6 percent interest during his or her period of military service.

A credit union who offers open-end home equity plans may not freeze the line or reduce the credit limit unless at least one of six conditions exists:

1. The value of the dwelling that secures the plan declines significantly below the appraised value;
2. The member is in default of a material obligation under the agreement (credit unions should look to state law to determine what is a "default of material obligation");
3. The priority of the credit union's security interest is adversely affected by government action so that the value of the security interest is less than 120% of the credit line;
4. The credit union is notified by its regulator that continued advances constitute an unsafe and unsound practice;
5. The credit union is precluded by government action from imposing the APR provided for in the agreement; and
6. The credit union reasonably believes that the member will be unable to fulfill the repayment obligations under the plan because of a material change in the member's financial circumstances.

If one or more of these conditions is met, then the credit union may freeze or reduce the line of credit under Regulation Z. Such action will also not be in violation of the SCRA, and the servicemember does not have any rights under the Act to prevent this action.

The fact that a credit union may not charge the contract rate on outstanding balances because a federal law requires a 6 percent loan rate does not come under

any of the conditions above, including the fifth condition in which the credit union is precluded by government action from charging the contract rate. The kind of government action contemplated under this condition is the passage of a state usury ceiling which would be lower than the contract rate. Thus, the creditor may not freeze the line or reduce the credit limit just because the SCRA requires the credit union to reduce the rate on outstanding balances to 6 percent.

If the credit union reasonably believes that the member will not be able to repay the loan because there has been a material change in his or her financial circumstances, the credit union may freeze the home equity line or reduce the credit limit. The fact that a servicemember has received a pay cut as a result of going on active duty may be a “material change” for purposes of Regulation Z, depending on how significant the pay cut is and what other sources of income the servicemember has. If there has been a material change, the credit union must “reasonably believe” that the member will not be able to pay the contract rate of interest plus principal owed on new advances in order to freeze the line. Credit unions must consider each member’s situation and determine whether or not to freeze the line or reduce the credit limit only after a thorough review of the servicemember’s financial circumstances.

Freezing lines of credit or terminating accounts under a credit card plan

Nothing in Regulation Z prevents a credit union from freezing a line of credit or terminating an open-end plan if the original agreement provides for such action, and the credit union reasonably believes that the borrower will not be able to repay the debt. However, credit unions must exercise caution when doing so for active duty servicemembers. Section 108 of the SCRA prohibits lenders (and others) from doing the following based on the servicemember’s request for or receipt of relief under the Act:

- Determining that the person is unable to pay the obligation or liability in accordance with its terms;
- Denying or revoking credit, changing the terms of an existing credit arrangement, or refusing to grant substantially the amount or on substantially the terms requested;
- Making an adverse report related to the creditworthiness of the person;
- Refusing to insure the person or changing the terms or conditions required for the issuance of insurance; or
- Placing a note on a servicemember’s loan file or credit record identifying that person as a member of the National Guard or reserve component.

The credit union cannot base its decision to freeze/terminate a credit line on the fact that the member has invoked his or her rights under the SCRA, e.g., asked for an interest-rate reduction. The credit union's decision to freeze or terminate a line of credit must be based solely on the fact that the member cannot afford to make payments on any additional credit obligations. Although this may work in theory, many creditors have found that they are not able to separate the servicemember's invocation of his or her SCRA rights from the credit union's decision to freeze or terminate the line of credit.

In any case, actions on the part of the credit union to prevent new advances under an open-end home equity line or credit card program may cut off access to credit for some servicemembers just at a time when they and their families need it the most. Rather than taking such action, credit unions and borrowers may want to renegotiate the loan agreement and enter in to a loan modification instead. Renegotiating contract terms is not prohibited by Regulation Z and is expressly authorized under the SCRA.

Disclosure requirements for closed-end loans

The only closed-end loans that will require additional TILA disclosures as a result of a rate change under the SCRA are variable-rate loans secured by a member's principal dwelling that have a term of greater than one year.

Regulation Z at Section 226.20(c) requires that for a variable-rate adjustment (which would include changing the rate to 6 percent and changing it back to the contract rate following active duty), at least 25 days and no more than 120 calendar days prior to the date that a payment at the new level is due, the credit union must make certain disclosures.

These disclosures include, as applicable:

1. The current and prior interest rates.
2. The index values upon which the current and prior rates are based.
3. The extent to which the credit union has foregone an increase in the interest rate.
4. Contractual effects of the adjustment, including the payment due after the adjustment and a statement of the loan balance.
5. The payment if different from the disclosure in number 4, that would be required to fully amortize the loan at the new interest rate.

It may not be easy to comply with these disclosure requirements when the rate is reduced to 6%. If the servicemember goes on active duty prior to the credit union's learning of his or her military status, problems may occur because the 6% interest applies immediately, but the adjusted payment amount may not be collected until 25 days after the variable-rate disclosure is mailed to the servicemember.

This creates an apparent conflict with SCRA. CUNA approached the Federal Reserve to clarify this issue.

The Fed has indicated that when the rate is lowered because of SCRA, it will permit a lender to lower the rate and give the disclosures at the same time. Also, it will not cite a lender for failing to give the disclosures 25 days before the change because SCRA requires an immediate reduction in the rate.

On the other hand, disclosures must be provided at least 25 days, but no more than 120 days, prior to the rate and payment being increased. The increase occurs at the time the member is discharged from active duty.

Specific Relief Provisions: Installment Contracts, Mortgages, Liens, Assignments and Leases

The Act provides relief for servicemembers in specific situations, for example where an installment contract or a mortgage is involved. This section reviews the specific relief provisions of the Act, including those in Article III relating to evictions, lease terminations, repossessions, mortgage foreclosures on real or personal property, installment sales contracts, and insurance contract assignees. The benefits in Article III described in this module apply to dependents as well as to servicemembers. With the exception of evictions, the provisions discussed below apply to obligations incurred prior to active duty.

Evictions and distress

Some creditors may, through foreclosure or default, become owners of residential property which may be rented to servicemembers and their families. As a landlord, the creditor may not evict a servicemember or the servicemember's dependents unless the creditor has obtained a court order. Section 301 regarding eviction applies when the dwelling is occupied primarily as a residence, and the monthly rent does not exceed \$2,400 (adjusted annually based on the consumer price index housing component). Landlords are also prohibited from subjecting premises to "distress" (seizure of property to secure payment of overdue rent) during the period of military service. Violators of this provision may be subjected to a fine and/or a year's imprisonment.

The court may stay eviction proceedings for up to 90 days, "unless justice or equity require a longer or shorter period of time" if it determines that a servicemember's ability to pay the rent is materially affected by military service. Once the court has stayed the eviction, the landlord may apply for relief under the provisions regarding installment contracts in Section 302 of the Act or mortgage foreclosures in Section 303. If the court renders a judgment that the military person

should make rental payments, the military may deduct the amount from the servicemember's pay.

Termination of leases

Section 305 of the SCRA permits servicemembers who are lessees to terminate "covered leases." A covered lease is:

- a lease of premises occupied, or intended to be occupied, by a servicemember or his dependents for a "residential, professional, business, agricultural, or similar purpose," *and* either (1) executed by or on behalf of a person who thereafter and during the term of the lease enters military service; or (2) executed by a servicemember while in military service who thereafter receives military orders for a permanent change of station or to deploy with a military unit for a period of at least ninety days.; or
- a lease of a motor vehicle used, or intended to be used, by a servicemember or a servicemember's dependents for personal or business transportation if (1) the lease is executed by or on behalf of a person who thereafter and during the term of the lease enters military service under a call or order specifying a period of not less than 180 days (or who enters service under a call or order specifying a period of 180 days or less and who, without a break in service, receives orders extending the period of military service to a period of not less than 180 days); or (2) the servicemember, while in military service, executes the lease and subsequently receives military orders for a permanent change of station outside of the continental U.S. or to deploy with a military unit for a period of not less than 180 days.

To terminate a covered lease, a servicemember must deliver written notice, along with a copy of his military orders, to the lessor or lessor's agent. He or she may deliver such notice by hand, private business carrier, or U.S. Mail, postage prepaid, return receipt requested. In addition, for motor vehicle leases, the servicemember must return the vehicle to the lessor credit union not later than 15 days after the date of the delivery of the written notice.

For a residential lease that provides for monthly payment of rent, once the notice is delivered, the termination is effective thirty days after the next rental due date. For a motor vehicle lease, termination is effective once the notice requirement and return of the vehicle are satisfied.

If a servicemember exercises his right to terminate a covered lease, a lessor may apply to a court for relief *before* the termination effective date. In the interest of justice, the court may modify the relief granted to the servicemember under this section.

The servicemember must pay the lessor for any rent or lease amounts due for the period before the termination effective date on a pro rata basis. If a

Review of TILA Disclosure Requirements Triggered By The SCRA Interest Rate Limitation

Open-End Loans

Change-in-terms notice required when the member is no longer on active duty and the credit union reinstates the contract rate.

Provide a change-in-terms notice not less than 15 days prior to rate increase.

Option: Change-in-terms notice requirement may also be satisfied when the credit union learns of the service member's active duty status. The notice must state that the original contract rate will be reinstated upon discharge from the military.

See Regulation Z, Section 226.9(c), Subsequent Disclosure Requirements, Open-End Credit, Change-in-Terms

Closed-End Loans

Additional disclosures only required for variable-rate loans secured by a member's principal dwelling that have a term of greater than one year.

Provide a change-in-terms notice at least 25 days and no more than 120 calendar days prior to a payment at the new level.

Disclosures include (as applicable):

- Current and prior interest rates.
- Index values for current and prior rates.
- Extent to which the credit union has foregone the interest rate increase.
- Contractual effects of the adjustment.
- If different from that originally disclosed, the payment to fully amortize the loan at the new interest rate.

See Regulation Z, Section 226.20(c), Subsequent Disclosure Requirements, Closed-End Credit, Variable-Rate Adjustments

servicemember paid advance rent for a period after the termination effective date, the lessor must refund such rent within 30 days of the termination effective date. For motor vehicle leases, the lessor-credit union may not impose an early termination charge, but any taxes, summonses, title and registration fees or other obligations of the lessee, including reasonable charges for excess wear and tear, use and mileage, etc. that are due and unpaid at the time of termination must be paid by the servicemember.

Installment contracts

If the court determines that the servicemember has been materially affected, it may stay the foreclosure proceedings or adjust the obligation to preserve the interests of all of the parties. Courts have the discretion to order relief that is

conditioned on the military member's performance, i.e., to stay the foreclosure as long as the member continues making payment as ordered by the court. The court also has the authority to determine how payments will be distributed. Based on prior cases, distribution is generally applied as follows: current and accrued taxes; hazard insurance; interest on the loan; principal.

Mortgage foreclosures

Section 303 of the SCRA provides that a creditor must obtain a court order before foreclosing on an active-duty servicemember's loan that is secured by a mortgage, deed of trust or other security in the nature of a mortgage on real or personal property. For the servicemember to be protected by this provision of the Act, the foreclosure must be instituted during the servicemember's military service and relate to an obligation incurred prior to active duty. Also, the property must be owned by the servicemember or a dependent prior to military service and still be owned when relief is sought.

The provisions regarding mortgage foreclosures provide servicemembers with protections that are similar to the ones in Section 302 regarding installment contracts, except that 303 applies if the credit is secured by a mortgage or similar instrument. This would include automobile loans if the auto serves as collateral for the loan.

If a creditor obtains a foreclosure and sale in the absence of a court order, the foreclosure will be voidable, unless the creditor and the servicemember entered into a loan agreement or modification after the member was inducted into service that allows the lender to foreclose on the loan and repossess the property. Violators of this provision may be subject to a fine and/or a prison sentence of no more than one year.

In order to get relief from a mortgage foreclosure, the servicemember must be able to show that he or she is materially affected by military service, i.e., that income during military service is inadequate to reasonably provide for the member. In making its determination, the court will look at the servicemember's income prior to and during military service. Service income will include military pay and allowances, such as for housing, allotments to dependents and other income, even if earned by the member's dependents.

Under Section 308 of the Act, dependents may apply to the court for the benefits accorded to military persons under Title III. If the court determines that the ability of the dependent to comply with the terms of an obligations, contract, leases, or bailment has been materially affected by the military service of the individual upon whom he or she depends, then the dependent will be entitled to the benefits of Title III to the same extent that the military serviceperson would be.

The 6% interest rate limitation does not expressly apply to dependents. Thus, if the servicemember is not the one who is obligated to repay the loan, the interest rate on the loan does not have to be lowered to 6%. However, if a dependent and servicemember are codebtors, such that the income of both has been considered in granting the loan and both are liable for repayment, the 6% interest rate limit should be applied to the loan.

Servicemember may apply for relief

The provisions discussed previously regarding installment contracts and mortgage foreclosures allow the courts to grant servicemembers relief after the credit union has sought legal action. Section 701, Article VII of the Act, allows the servicemember to petition the court during active duty for relief from financial obligations.

Section 701 applies to all loan obligations or liabilities incurred prior to active duty. The servicemember does not have to be in default to seek the court's help.

In order for the court to provide relief, once again the serviceperson must be able to show that he or she has been materially affected by active-duty status. The kind of relief the court will grant will depend on whether the loan is real estate related or not.

If the loan is for the purchase of real estate or is secured by real estate, the court may grant a stay and suspend all payments while the member is on active duty. The court will order back payments with interest to be made up and may do so by directing the credit union to spread payments out equally for a period of time that includes the remaining term of the loan and the amount of time the military member was in service. This means that if the remaining term of the loan is eight years and the member was on active duty for ten months, the period for repaying the loan could be up to eight years and ten months after the member is no longer on active duty.

For debts that are not real estate related, the time period for making up missed payments will be no longer than the amount of military service. Thus, for example, if an individual is on active duty for 18 months, the time period for repaying the loan could be no longer than 1-1/2 years after the member is no longer on active duty.

The time frames for repaying missed payments discussed above are the maximum allowed under this provision, and the court has the discretion to order a shorter time period for repayment, depending on the servicemember's financial situation. In addition to making up back payments, the servicemember must make regularly scheduled payments due after active duty has terminated.

Settlement of cases involving personal property

Section 304 provides that in a proceeding to foreclose on a mortgage involving personal property or to resume possession of the property, the court may appoint three “disinterested” parties to appraise the property and upon their report, order the creditor to pay the amount of the servicemember’s equity in the property to the servicemember or his or her dependent(s) as a condition to the foreclosure or repossession. The court will not order the appraisal if, in its opinion, it would create an undue hardship on the dependents of the servicemembers.

Rights of Dependents and Co-Obligors

The provisions in Title III of the Act grant certain benefits to the dependents of military service personnel. Certain benefits also accrue to co-obligors, sureties, and guarantors of military service personnel which are also discussed in this section. These benefits are found in Section 103 of the Act.

SCRA benefits which extend to dependents

Title III of the Act concerns relief to servicemembers from evictions, lease terminations, installment sales contracts, repossessions, mortgage foreclosures on real and personal property, storage lien foreclosures, and the rights of life insurance contract assignees. These benefits are the only ones that are also expressly provided to dependents of military service personnel under the Act. The Act defines “dependent” as the servicemember’s spouse, child, or an individual for whom the servicemember provided more than one-half of the individual’s support for 180 days immediately preceding an application for SCRA relief.

Section 302 of the Act applies to contracts for the purchase of real or personal property through installment payments that a servicemember entered into prior to military service. It provides that if a servicemember has paid a deposit or installment of the purchase price prior to military service, the seller may not, without court action, exercise a right or option to terminate the contract or repossess the property for nonpayment that occurs prior to or during military service. Violators may face a fine and/or be subject to a year’s imprisonment.

In determining whether a servicemember has been materially affected under this provision, the court will likely look to his financial status before and during military service. The court may order repayment of the prior installment as a condition of terminating the contract and allowing the creditor to resume possession of the property, order a stay of the proceedings, or make any other disposition of the case as it determines to be fair to all parties.

SCRA Relief Provisions Covering Dependents

- Evictions
- Lease terminations
- Installment sales contracts
- Repossessions
- Storage lien foreclosures
- Rights of life insurance contract assignees

The 6% interest rate limitation does NOT specifically apply to dependents, unless both the dependent and the servicemember are liable for repayment (for example, co-debtors).

Relief for co-obligors

Section 103 of the Act provides that individuals who are sureties, guarantors, endorsers, and accommodation makers of a member of the military, are entitled to the same rights to have legal actions stayed and decisions vacated or suspended as are servicemembers. Thus, the court in its discretion may grant stays, postponements, and suspensions, as well as vacate and set aside prior judgments for such individuals, whether they are primarily or secondarily liable on obligations with a servicemember.

Insurance Provisions

Title IV of the Act provides that upon application to the Department of Veterans Affairs, the servicemember may be entitled to have the VA guarantee premiums and interest on a life insurance policy during active duty service and for up to two years after. The insurance provisions in Title IV apply to a policy that insures a servicemember's life, and may not exceed \$250,000, or an amount equal to the Servicemember's Group Life insurance maximum, whichever is greater, regardless of the number of policies submitted. The policy must be in force when the member applies for benefits, and the policy must have been taken out and at least one premium paid within 180 days before the individual entered military service.

In addition to the insurance provisions of Title IV, Section 306 of the SCRA generally provides that where an individual, prior to active duty, has assigned the rights to proceeds under an insurance policy as collateral for a loan, the creditor (i.e., the assignee) may not attach the proceeds before obtaining court approval during the period of military service and for up to one year thereafter. The court will not grant approval under this provision for the creditor to attach the proceeds if it determines that the servicemember has been materially affected by active duty.

There are some exceptions to this. If the servicemember provides written consent for the assignment after entering military service; if the insurance premiums are unpaid; or if the insured person dies, the assignee may exercise rights under the assignment without having to seek court approval first.

The Servicemembers Civil Relief Act

Quiz/Study Guide

1. What are the three tests set up by the Act to determine if an individual will be protected?

2. What must a servicemember covered by the SCRA do to receive reduced rates?

3. If the credit union and the member agree to modify or renegotiate the terms of the obligation, does the member waive all rights to the provisions of the Act?

Yes No

4. Under the Act, what is the interest rate limit for members on active duty status?

5. If the credit union does not believe the member qualifies for the interest rate reduction, what action can be taken?

6. How does the SCRA treat lost interest?

7. Under the Act, what constitutes materially affected?

8. At what point can the interest rate be raised to the original contract rate?

The Servicemembers Civil Relief Act

Answer Key

1. The three part coverage test — Is the member: 1) in the military service of the United States; 2) on active duty; and 3) materially effected as a result of active duty status. **(Page 3-6)**
2. The SCRA requires the servicemember to provide creditors with a written notice and a copy of the military orders calling the servicemember to active duty, as well as any orders further extending military service. The notice must be provided not later than 180 days after the date of the servicemember's termination or release from military service. Once the credit union receives this notice, it must reduce the interest rate on any preservice debt as of the date on which the servicemember was called to military service. **(Page 3-13)**
3. No. A mutually agreed upon modification allows the credit union to collect payments without judicial intervention and may allow a loan rate of greater than 6 percent. However, even though the servicemember agrees to the modified terms, he or she does not waive all other rights under the Act, such as the right to have court proceedings stayed or vacated. **(Page 3-8)**
4. The maximum allowable interest is 6% on loans taken out prior to going on active military duty. Any future advances would be at the original contract rate. **(Page 3-12)**
5. The credit union must prove in court that the servicemember's ability to repay the loan at the original interest rate has not been materially affected by being placed on active military duty. **(Page 3-14)**
6. The credit union must forgive any interest in excess of 6% that would have been incurred by the member if no rate cap was in effect. The term "interest" includes service charges, renewal fees, or any other charges (except bona fide insurance) with respect to an obligation or liability. In addition, Section 207(a)(3) of the SCRA requires credit unions to reduce "the amount of any periodic payment due from a servicemember ... by the amount of the interest forgiven ... that is allocable to the period for which the payment is made. **(Page 3-12)**

revision

7. Materially affected means: 1) unable to take full advantage of legal rights (not being able to appear in court); and 2) unable to meet financial obligations as a result of active duty (a cut in pay). **(Pages 3-4 to 3-5)**
8. When the member goes off active duty. **(Page 3-15)**