

**Servicemembers' Civil Relief Act and Other
Military Matters**

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2016 Compliance School**

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SCRA and Other Military Matters for Bankers

I. Overview

A. Coverage of this session will include both Servicemembers' Civil Relief Act (SCRA) and Military Lending Act (MLA)

B. SCRA

1. Purpose – to enable men and women serving in the Armed Forces to devote their entire focus and energy on defense needs of the nation without worrying about distracting civil matters related to obligations on the home front.
2. Civil matters covered – include loans, leases, lawsuits and insurance contracts
3. Statute at 50 USC Chapter 50, no implementing regulations – Previously had been at 50 U.S.C. Appendix. A chart comparing former to current citations can be found at www.bankersonline.com/regulations/scra-xref

C. Military Lending Act

1. Implemented as part of National Defense Authorization Act in October 2006 and amended in January 2013 - Limitations on Terms of Consumer Credit Extended to Service Members and Dependents
2. Statute at 10 USC 987, Department of Defense Regulations at 32 CFR §232

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3. Regulates amount of charges and disclosures required for certain types of consumer loans made to service members and their dependents – coverage expanded on 10/1/2015 with compliance optional until 10/1/2016 (optional compliance until 10/1/2017 for credit cards)
4. Purpose – relief of financial strain from certain typically high-cost financing options where service members and their families are often the victims of unscrupulous lenders, creating unneeded financial stress

D. History

1. Roots of SCRA go back to US Civil War
2. SSCRA first enacted by Congress in 1918
 - a. Prevented repossession and foreclosure on property of military personnel returning from WWI
3. SSCRA expired and was re-enacted in 1940 – just before WWII
4. Further updates resulting from Persian Gulf conflict in 1990 - 1991
5. Substantially revised and renamed as SCRA in 2003 in aftermath of 9/11
6. Talent Amendment enacted in 2007
7. Further minor revisions enacted in '06, '08, '12, and '14

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II. SCRA

A. Coverage – 50 USC Section §§3911, 3913, 3914, 3917 and 3918.

1. Active duty in federal military service - Army, Navy, Marine Corps, Air Force, Coast Guard, and commissioned officers with Public Health Service or National Oceanic and Atmospheric Administration.
2. US Citizens on active duty in the forces of a nation with which US is allied in fighting war or military action
3. Dependents of the servicemembers covered by some protections, but not all.
 - a. Includes spouse, child, and any individual for which the servicemember provided at least 50% of support during 180 days preceding request for relief
4. SCRA applies to any civil, judicial, or administrative proceeding in any court or agency subject to jurisdiction of the US
5. Servicemembers may waive any right or protection afforded by the act (but see below for restrictions applicable to MLA). Must be executed either while on active duty or after receipt of orders to active duty. Waiver must be in writing:
 - a. If pertaining to modification, termination, or cancellation of a lease, contract, or

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obligation secured by a mortgage, deed, or lien; or

- b. If related to a repossession, retention, foreclosure, sale, forfeiture, or taking possession of property that is security for an obligation or purchased under a contract, lease, or bailment
6. Protections generally apply during period of military service
- a. Early protection for Reservists - A member of a military reserve component who is ordered to report for military service is entitled to the rights and protections of Titles I, II, and III of the SCRA beginning on the date of the member's receipt of the order
 - b. Early protection for Inductees - A person who has been ordered to report for induction under the Military Selective Service Act is entitled to the rights and protections of SCRA Titles I, II, and III beginning on the date of receipt of the order of induction
 - c. Full protection under SCRA for reservists and inductees begins on date of reporting for active duty
- B. General requirements – 50 USC §§3919, 3937, and 3938
1. Exercise of rights under SCRA **CANNOT** be a basis for various actions, including

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- a. A determination that servicemember is unable to pay an obligation in accordance with its terms
 - b. A denial or revocation of credit
 - c. A change in the terms of an existing credit arrangement
 - d. Refusal to grant credit in amount or terms requested
 - e. Adverse creditworthiness reporting
 - f. Notating record that servicemember is a member of the National Guard or reserve component
 - g. Refusal to insure a servicemember by an insurer
2. Interest Rate Cap – 50 USC §3937
- a. Debt incurred prior to entrance to active duty
 - b. Loan to servicemember or jointly with servicemember and spouse
 - c. Shall not bear interest in excess of 6% per year
 - d. Definition of “interest” includes all fees and other charges (except bona fide insurance charges), such as service charges, renewal charges, late payment charges

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- e. Interest in excess of 6% is to be forgiven, not deferred
- f. Amount of installment payments to be reduced by amount of forgiven interest
- g. Lenders must account for any interest paid in excess of 6% that occurred after orders were received but before creditor was notified of relief request. Lender should give borrower option of receiving bulk refund, applying to principal balance, or apply to future monthly payments
- h. Servicemember must provide notice to lender and copy of military orders to active duty
- i. Notice and request for relief can be provided up to 180 days after active duty service ends
- j. Interest rate cap continues for term of active duty service. For debt secured by mortgage or deed of trust, rate cap continues for 1 year after completion of active duty service
- k. Creditor can petition court for relief from the rate cap request if the servicemember's ability to pay interest at a rate greater than 6% is not materially impacted by reason of the servicemember's military service (but beware of the reputation risk associated with this tactic)

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- iii. In actions to execute judgments or attachment or garnishment of property against a servicemember that began before or during their period of service (or within 90 days after), the court shall stay the execution or vacate or stay the attachment or garnishment, unless the court determines that the ability of the defendant is not materially affected by his/her military service
- iv. The period of military service will not be used in computing any statute of limitations for legal proceedings.

4. Contracts, Loans, and Leases

- a. Without a court order, repossessions and foreclosures are almost always prohibited when a borrower is on active duty. An attempted repossession or foreclosure in violation of the SCRA is void and can result in criminal penalties. The protection against foreclosure of a mortgage or deed of trust extends for 12 months after a servicemember returns from active duty (reverts to 90 days on 1/1/18 unless further extended or amended).
- b. Protection also extends to termination of installment contracts for the purchase or lease of personal property entered into prior to active duty. Under this provision, some examiners now looking for SCRA procedures to be incorporated into Safe Deposit Box rentals.

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- c. Property leases can be terminated by a servicemember if the lessee enters military service during the lease term. Leases can also be terminated if lessee is in the military when the lease is signed but thereafter receives PCS orders or deployment of 90 days or more. No penalty may be assessed.
 - d. Vehicle leases can be terminated by a servicemember if lessee subsequently enters military service under a call or order specifying a period of 180 days or more. Leases can also be terminated if lessee is in the military when the lease is signed but subsequently receives PCS orders outside of continental US or deployment of 180 days or more. No early termination charge can be assessed for such termination.
5. Federal Student Loans
- a. Added to SCRA protections in 2008
 - b. Applies to borrowers in military service as of August 14, 2008
 - c. SCRA interest rate limit does not apply to an endorser of a PLUS loan made to a parent or a graduate or professional student unless that person is also performing eligible military service
6. Evictions – Section 531
- a. No evictions from dwelling housing occupied by a servicemember or the

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dependents of a servicemember during a period of military service if the monthly rent does not exceed the established amount. Currently amount is \$3,329.84 and is subject to change annually. This could have implications for OREO property that is leased.

7. Life Insurance

- a. If a life insurance policy on the life of a service member is assigned before military service to secure the payment of an obligation, the assignee of the policy (except the insurer in connection with a policy loan), may not exercise, during the period of the service member's military service or within one year thereafter, any right or option obtained under the assignment, absent compliance with a court order unless the insured party gives written consent; the premiums on the policy are due and unpaid; or the insured dies

8. Past Due Notice – for dwelling-secured loans, a SCRA notice provided by HUD (Form 92070) is required to be included in past due notice.

C. Term of Benefits and Protections

1. Rights and protections continue through period of military service (and afterward as specified in various parts). Where a servicemember has been reported as missing, he/she will be presumed to remain in service until accounted for. No period that is limited by the death of a person will begin or end until

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the servicemember's death is reported to the Department of Defense.

III. Military Lending Act

A. Covered Consumer Credit

1. Payday loans – Closed end, term of 91 days or less, \$2,000 or less, charged interest or a fee, and either:
 - a. Receives a check from the borrower and agrees to not deposit or cash the check for more than one day; or
 - b. Borrower authorizes creditor to initiate a debit or debits to the borrower's deposit account more than one day later
2. Vehicle Title Loans – Closed end, term of 181 days or less, secured by a motor vehicle registered for road use and owned by the borrower, other than a purchase money loan
3. Tax Refund Anticipation Loans – Closed end, borrower expressly grants creditor right to receive all or part of the borrower's income tax refund or expressly agrees to repay the loan with proceeds of the borrower's refund

B. Covered Borrowers

1. A regular or reserve member of the Army, Navy, Marine Corps, Air Force, or Coast Guard, serving on active duty under a call or order that does not specify a period of 30 days or fewer, or such a member serving on Active

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Guard and Reserve duty as that term is defined in [10 U.S.C. 101\(d\)\(6\)](#), or

2. The member's spouse, the member's child defined in [38 U.S.C. 101\(4\)](#), or an individual for whom the member provided more than one-half of the individual's support for 180 days immediately preceding an extension of consumer credit covered by this part.
- C. Creditor obligated to provide applicants for covered credit with a “Covered Borrower Identification Statement” (content specified at 32 CFR §232.5) prior to becoming obligated. For borrowers identified as covered borrowers, regulation restrictions apply. Creditor may (but not required to) verify status by review of current or prior month Military Leave and Earnings Statement, or Military ID card, or check on DoD database – www.dmdc.osd.mil/mla/welcome.xhtml
- D. Requirements
1. *MAPR*. The Military Annual Percentage Rate, or MAPR, is capped at 36% for consumer credit to “covered borrowers. MAPR is a broader calculation than finance charges or APR under Regulation Z and includes credit insurance premiums, fees for credit-related ancillary products, and some other fees.
 2. *Particular Disclosures*. The MAPR must be disclosed together with the total of all charges included in the MAPR. A specific disclosure regarding rights under the SCRA must be

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provided verbally and in writing in addition to Regulation Z disclosures.

3. *Prohibited Terms*. Several terms are prohibited, including mandatory arbitration, prepayment penalties, and waivers of rights under the SCRA. Rollovers, renewals, refinancings, or consolidations by the same covered borrower and creditor are prohibited unless they result in more favorable terms to the borrower.

E. Expansion effective 10/1/2016 and 10/1/2017

1. DoD issued final rule on 7/22/2015 effective 10/1/2015 with compliance optional until 10/3/2016 (compliance optional until 10/3/2017 for credit card accounts)
2. Expands definition of covered credit to include all consumer credit except residential mortgages and purchase money credit
3. Safe harbor protection now requires creditor to confirm borrower status on DoD database or through a national consumer reporting agency instead of reliance on Covered Borrower statement.
4. MAPR capped at 36%. Finance charges under Reg Z are included in the MAPR calculation, but so are some additional fees and charges even if they would not be considered finance charges under Reg Z:
 - a. Credit insurance premiums and fees for debt cancellation or debt suspension agreements;

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- b. Fees for credit-related ancillary products sold in connection with the credit transaction or account;
 - c. Finance charges associated with the consumer credit; and
 - d. Certain application fees and participation fees, including annual fees
 - e. Exclusion for certain credit card fees if bona fide and reasonable, such as cash advance fees, over limit fees, etc.
5. Streamlined disclosure requirements
- a. Disclosures provided at or before consumer becomes obligated
 - b. 3 elements:
 - i. A statement of the MAPR applicable to the loan (specific standards for what must be included; model statement provided)
 - ii. Any disclosure required by Regulation Z
 - iii. A clear description of the payment obligation of the loan (Reg Z disclosures suffice for this)
 - iv. Disclosures must be provided both in writing in a form the consumer can keep and orally.
6. Prohibited practices
- a. No rollovers, renewals, refinances or consolidation loans regarding covered credit except by banks, savings associations or credit unions

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- b. No waiver of legal recourse, including waiver of SCRA rights
- c. No mandatory arbitration clauses
- d. No unreasonable notice requirements in event of a dispute
- e. No use of a vehicle as security for the obligation, except if the creditor is a federally or state-chartered bank, savings association or credit union
- f. No requirement that borrower establish an allotment to repay the debt.
- g. No prohibition of prepayment nor any penalty for prepaying all or part of the credit

IV. Interagency Guidance on Mortgage Servicing Practices Concerning Military Homeowners with Permanent Change of Station Orders

- A. Issued in 2012 because of a number of loan servicing practices were causing harm to servicemembers
 - 1. Failing to provide homeowners with PCS orders with clear, accurate, and readily understandable information about available assistance options for which they may qualify
 - 2. Asking homeowners with PCS orders to waive legal rights under SCRA as a prerequisite to providing information about options available or evaluating homeowners eligibility for assistance
 - 3. Advising homeowners with PCS orders who are current on their loans and able to make the

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monthly payments to intentionally skip payments in order to create appearance they are having financial difficulties in order to qualify for assistance they would otherwise not qualify for

4. Failing to provide a reasonable means for homeowners with PCS order to obtain information about the status of their request for assistance
5. Failing to timely communicate decisions regarding requests for assistance and failing to provide reasons for denial, where required.

B. Guidance expects servicers to ensure adequate training and procedures are in place regarding PCS orders.

C. Violations will likely be considered UDAAP violations.

V. Penalties

A. Civil and Criminal

1. Private rights of action, damages, attorney's fees
2. Knowing violation of SCRA or MLA is a misdemeanor and will be subject to fines and imprisonment of up to one year, or both
3. Any credit that fails to comply with MLA is void from its inception

B. FIRREA Penalties

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1. Up to \$7,500 per day for violation of laws and regulations
2. Up to \$37,500 per day for violations or unsafe/unsound practices engaged in recklessly or part of a pattern of misconduct that causes more than minimal loss to the bank or any gain to parties involved
3. Up to \$1,425,000 per day for knowingly committing a violation and knowingly or recklessly causing a substantial loss to the bank or substantial benefit to the party

VI. Best Practices

A. Policies, Procedures and Training

1. Interest rate relief requests
2. Collection activities
3. OREO

B. Routine Collection Check of Military Status

C. Incorporate SCRA for Safe Deposit Box past due collection and drilling

D. Take advantage of the DoD database

E. Keep a copy of both input and output screens when searching on DMDC or MLA websites

F. For repossessions, if there is a lag of more than 6 months from the date you did your search on the

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DMDC and the date you actually repo the vehicle, do another search

- G. Be sure your commercial bankers are fully aware that the rule applies to them and they know the requirements
- H. Be sure you have vetted all third parties you use in any SCRA-covered process (e.g., collection agencies)

VII. Exam Procedures

- A. Review of policies, procedures, and training
- B. Sample of interest rate relief requests
- C. Sample of collection, repossession and foreclosure actions
- D. Review complaints
- E. Most common violation – using incorrect date for interest rate relief for reservists called to active duty – not date of active duty but date of receipt of orders

VIII. Additional Resources

- A. BankersOnline.com SCRA Page:
www.bankersonline.com/regulations/SCRA
- B. BankersOnline.com MLA Page:
www.bankersonline.com/regulations/32-232-000

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- C. Interagency Guidance – PCS:
http://files.consumerfinance.gov/f/201206_cfpb_PCS_Orders_Guidance.pdf

- D. DoD Database:
<https://mla.dmdc.osd.mil>

- E. OCC SCRA Handbook:
<http://www.occ.treas.gov/publications/publications-by-type/other-publications-reports/scra.pdf>

- F. FDIC Compliance Manual – SCRA:
<https://www.fdic.gov/regulations/compliance/manual/pdf/V-11.1.pdf>

- G. HUD SCRA Notice:
http://www.bankersonline.com/tools/lender/hud_scra.html

3 percent cap on troops' interest rates? Senator proposes broad protections

Karen Jowers, Military Times 10:45 a.m. EDT March 18, 2016



(Photo: Alex Brandon/AP)

A proposal to limit interest rates on all troops' loans to 3 percent would offer unprecedented sweeping new benefits to service members if it became law.

Sen. Patty Murray, D-Wash., introduced the SCRA Enhancement and Improvement Act of 2016 on Thursday, proposing stronger and more far-reaching financial legal protections under an amended Servicemembers' Civil Relief Act.

Under the SCRA, service members are supposed to receive a 6 percent interest rate cap on debts incurred before they enter active duty. That applies to loans service members took out either before they joined the military on active duty, or before they are called to active duty as a Guard or Reserve member.

The legislation proposed Thursday would require all loans to service members be capped at a 3 percent interest rate, regardless of when the debt is incurred. For service members who are eligible for hostile fire pay or imminent danger pay, the interest rate would be zero.

If this legislation becomes law, it could mean that service members could not be charged more than 3 percent for any loan, including mortgages and credit cards.

The proposed legislation would have to move through a number of steps before becoming law and some observers say it is a long shot,

"I'm sure this is well-intended, but the rate seems awfully low," said one representative of an organization that advocates for the military community. While the organization is supportive of benefits for service members, requiring a 3 percent ceiling on interest rates could lead to military members being unable to obtain loans or credit cards, he said.

But that wouldn't be a problem under Murray's bill, contends Murray spokeswoman Kerry Arndt. She said the bill would prohibit lenders from denying credit because of eligibility for SCRA protections, so service members wouldn't see any reduction in access to credit and they would be protected from predatory and unfair practices.

Murray, the top Democrat on the Senate Health, Education, Labor and Pensions Committee and a senior member of the Senate Veterans' Affairs Committee, said that businesses haven't always honored Servicemembers' Civil Relief Act protections, and the law needs to be strengthened. The most recent example is student loan servicers who overcharged military borrowers after they were called to active duty. Some servicers did not reduce the rates to 6 percent.

"In recent years, we've seen our service members subjected to predatory practices and unfair treatment on several fronts, from overcharges on their student loans, to foreclosures on their homes when they're deployed. That is simply unacceptable," Murray said in a statement announcing the proposed changes.

The legislation would require student loan servicers of federally guaranteed student loans to automatically apply the interest rate cap, and provide timely responses to inquiries. The servicers would also be required to have a designated service representative or point of contact for service members and ensure that these staff are properly trained.

If a service member dies in the line of duty, federal and private student loan debt would be forgiven.

The proposed legislation includes some other expanded protections — including prohibiting prepayment penalties if a mortgage is paid off early for reasons related to a permanent change-of-station move.

It would also allow service members to cancel contracts on cable TV and Internet services in the event of permanent change-of-station moves. Currently, similar protections are offered for residential and auto leases and cellphone contracts.

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Karen Jowers covers military families, quality of life and consumer issues for Military Times. She can be reached at kjowers@militarytimes.com (<mailto:kjowers@militarytimes.com>).

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Military Lending Act Rule (32 C.F.R. pt. 232)

Recommended Clarifications and Modifications

April 2016

The American Bankers Association, the American Financial Service Association, the Association of Military Banks of America, the Consumer Bankers Association, the Credit Union National Association, the Independent Community Bankers of America, the National Association of Federal Credit Unions, and the Financial Services Roundtable submit the following suggested clarifications and modifications to the Military Lending Act regulation for which compliance is mandatory on October 3, 2016. We urge the Department of Defense to adopt on an interim basis and propose for public comment “final interim” amendments to the regulation to promote transparency and consistency for covered borrowers, consumers, regulators, courts, and the lending industry. Providing guidance on the issues discussed below will help ensure that military personnel and their spouses and dependents continue to have access to a wide range of credit products. Please contact Nessa Feddis (nfeddis@aba.com, 202 663 5433) or Steven Lepper (Steven.Lepper@AMBAHQ.org, 540-347-3305) for further information.

I. Use of a Check or Other “Method of Access” to Make Payments

- **Issue:** Section 232.8(e) provides that it is unlawful if a creditor “uses a check or other method of access to a deposit, savings, or other account maintained by the covered borrower,” subject to certain exceptions. The regulation thus appears to prevent creditors from accessing accounts by accepting payments from covered borrowers by check or via an electronic fund transfer (as defined in Regulation E, 12 C.F.R. pt. 1005), including, for example, via ACH debits. We do not believe this result was intended because it will be harmful to covered borrowers, particularly those deployed overseas, who will not be able to use all available payment options.

- **Proposed Solution:** Amend § 232.8(e) by adding a new paragraph (4) to state:

(4) This paragraph (e) does not prohibit a covered borrower from making a payment or a creditor from accepting a payment by use of a check or other method of access to a deposit, savings, or other account maintained by a covered borrower for an extension of consumer credit after the consumer has become obligated on a transaction or an account has been opened.

II. Taking a Security Interest in Funds

- **Issue:** Section 232.8(e)(3) provides that, if not otherwise prohibited by applicable law, a creditor may take a security interest in funds “deposited *after* the extension of credit” in an account. This provision will prevent covered borrowers from receiving secured credit cards and other loans secured by funds placed in a deposit account, such as a savings

account or CD, *before or at the time of* an extension of credit, which can be an important source of credit for some consumers, including covered borrowers and can enable them to establish or improve their credit history.

- **Proposed Solution:** Amend § 232.8(e)(3) to state:

(3) If not otherwise prohibited by applicable law, take a security interest in funds deposited ~~after the extension of credit~~ in an account established **or maintained** in connection with the consumer credit transaction.

III. Inclusion of Conditional Terms and Disclosures in Agreements

- **Issue:** The broad language in § 232.9(c) regarding contract voidance raises the risk that creditors will no longer be able to use a single agreement for all borrowers that includes disclosures in the agreement. To reduce operational burden and risk and ensure covered borrowers receive the correct contract terms, many creditors would prefer to use a single credit agreement for all borrowers that includes:
 - Provisions prohibited by part 232 (including arbitration) but affirmatively states that those provisions do not apply to covered borrowers;
 - The MAPR statement, consistent with § 232.6(c)(2); and
 - The Regulation Z disclosures, consistent with longstanding practice for certain products.

However, creditors are concerned that inclusion of a prohibited provision (even with an affirmative statement that it does not apply to covered borrowers) or an inadvertently erroneous disclosure will result in a court deeming a contract void under § 232.9(c).

- **Proposed Solution:** Amend § 232.9(c) to state:

(c) *Contract void.* Any credit agreement, promissory note, or other contract with a covered borrower that fails to comply with 10 U.S.C. 987 as implemented by this part or which contains one or more provisions prohibited under 10 U.S.C. 987 as implemented by this part is void from the inception of the contract. **However, a credit agreement, promissory note, or other contract is not void solely because it includes:**

**(i) An otherwise prohibited provision that expressly excludes covered borrowers;
or**

(ii) A disclosure required by § 232.6 that fails to conform with the applicable timing, content, or format requirements. This provision does not affect any other applicable remedies under this part.

IV. Timing of Written Disclosures

- **Issue:** Section 232.6(a) and (d) states that a creditor must provide the required disclosures to a covered borrower in writing in a form the borrower may keep “before or at the time” a consumer becomes obligated on a transaction or establishes an account. While longstanding provisions of Regulation Z permit delayed provision of disclosures for telephone and similar purchases, the timing requirement in § 232.6(a) and (d) would prevent covered borrowers from obtaining credit for emergencies or other purposes by telephone. We believe covered borrowers would benefit from being able to make telephone and similar purchases and receiving all of the MLA disclosures consistent with the Regulation Z timing requirements for those purchases.
- **Proposed Solution:** Amend § 232.6 by adding a clause in paragraph (a) and adding a new paragraph (a)(4) to state:

(a) *Required information.* With respect to any extension of consumer credit (including any consumer credit originated or extended through the internet) to a covered borrower, **except as provided in paragraph (a)(4) of this section**, a creditor shall provide the covered borrower the following information before or at the time the borrower becomes obligated on the transaction or establishes an account for the consumer credit:

(4) Notwithstanding the requirements of this paragraph, a creditor may provide the information in paragraphs (a)(1) through (3) for mail, telephone, or facsimile machine purchases in accordance with the timing provisions of Regulation Z, 12 C.F.R. §§ 1026.5(b) and 1026.17(g) for open-end accounts and closed-end transactions, respectively.

V. Oral Disclosures

- **Issue:** Section 232.6(a)(3) and (d)(2) require creditors to provide orally a description of the payment obligations of the borrower before or at the time the borrower becomes obligated on a transaction or establishes an account. Alternatively, a creditor may provide certain Regulation Z disclosures, which could require a highly complex, individualized oral disclosure that will likely be confusing and unhelpful to covered borrowers who receive more specific disclosures in writing. In addition, individualized oral disclosures will not be operationally feasible or practical for creditors and will likely cause them to consider discontinuing certain products.

- **Proposed Solution:** Permit creditors to comply by providing a model statement orally, similar to the model statement for the MAPR in § 232.6(c)(3) and consistent with the intent of § 987(c)(1)(C) of the statute that covered borrowers understand their payment obligations. Amend § 232.6(c) to add a new paragraph (4):

(4) *Model statement.* A statement substantially similar to the following statement may be used for the purpose of paragraph (a)(3) and (d)(2) of this section: “Federal law requires that you receive a clear description of your required payments. Please review the disclosures and your credit agreement carefully to understand your payment obligations.”

VI. Timing of Database Inquiry

- **Issue:** Section 232.5(b)(3) provides that a creditor may only obtain the safe harbor for the covered borrower determination if it makes the determination described in § 232.5(b) and keeps the record of the information obtained “solely at the time” (1) a consumer initiates the transaction or 30 days prior to that time, (2) a consumer applies to establish the account or 30 days prior to that time, or (3) the creditor develops a “firm offer of credit.” Under this provision, a creditor would not be able to obtain the safe harbor if it determines whether an applicant is a covered borrower after a consumer applies for a loan. However, for operational and other reasons, creditors may not be able to make this determination until after a consumer applies for an account. Lenders should be able to make the determination at any time prior to account opening.
- **Proposed solution:** Amend the last sentence of § 232.5(b)(3) and subparagraphs (b)(3)(i) and (ii) to read:

(3) *Determination and recordkeeping; one-time determination permitted.* . . . A creditor may make the determination described in this paragraph (b), and keep the record of that information obtained at that time, solely at the time—

- (i) A consumer ~~becomes obligated on~~ ~~initiates the a~~ transaction or ~~during the 30–days period~~ prior to that time;
- (ii) A consumer ~~applies to~~ ~~establishes the an~~ account or ~~during the 30–days period~~ prior to that time; or
- (iii) The creditor develops or processes, with respect to a consumer, a firm offer of credit that (among the criteria used by the creditor for the offer) includes the status of the consumer as a covered borrower....

VII. Safe Harbor for Assignees

- **Issue:** Section 232.3(i) provides that, as used in part 232, a “creditor” includes an assignee, subject to certain exceptions. However, § 232.5(b)(2)(i)(B) states that “a

creditor (*including an assignee*)” may not engage in an historic lookback of the DOD database to determine if a consumer had been a covered borrower. While this discrepancy was likely unintentional, it could be read by a court to mean that, for purposes of § 232.5, “creditor” does not include an assignee unless specifically stated and therefore an assignee may not rely on the creditor’s covered borrower determination. This could have a significant impact on the ability of creditors to sell loans because of the uncertainty of whether an assignee can rely on the safe harbor provided to creditors.

- **Proposed Solution:** Amend § 232.5(b)(2)(i)(B) by deleting the phrase “(including an assignee)” after the word “creditor.”

VIII. Exemption for Credit Secured by Real Estate With No Dwelling

- **Issue:** Section 232.3(f)(2)(i) and (iii) excludes from coverage residential mortgages secured by a “dwelling, including a transaction to finance the purchase or initial construction of the dwelling.” However, loans secured by real property that do not contain a dwelling are not excluded. For example, consumers sometimes purchase vacant land for vacation or retirement purposes without at the same time obtaining a loan to construct a dwelling. We believe that this is an unintended oversight, but it could restrict covered borrowers’ access to such loans.

- **Proposed solution:** Amend § 232.3(f)(2) by replacing existing paragraph (i) with:

(i) A residential mortgage, which is any credit transaction secured by an interest in **real property or** a dwelling, including **a transaction to finance the purchase of real property,** a transaction to finance the purchase or initial construction of a dwelling, any refinance transaction, **any** home equity loan or line of credit, or **any** reverse mortgage;

IX. MAPR Calculation – Zero Balance Billing Cycles

- **Issue:** Section 232.4(c)(2)(ii)(B) provides that if there is “no balance” in a billing cycle, a creditor may not impose “any fee or charge” during that cycle, except for a participation fee on open-end credit plans so long as it does not exceed \$100 per year, except that the \$100 per year limit does not apply to bona-fide credit card participation fees. This provision creates several problems.

First, this provision prohibits a creditor from imposing an application fee for an open-end (non-credit card) plan, including overdraft lines of credit and personal lines of credit, if there is no balance in the billing cycle when the application fee is imposed. Consumers frequently establish open-end (non-credit card) plans without immediately taking an advance. In this case, a creditor would be prohibited from assessing an application fee. This could lead creditors to impose (annual) membership fees rather than one-time application fees, which may be harmful to consumers, including covered

borrowers. Thus, we believe the provision should be revised to treat application fees in as participation fees are treated.

Second, as worded, this provision inadvertently fails to give full effect to the bona fide fee exclusion and could be read to prohibit all open-end accounts, including credit card accounts, from imposing, for example, a minimum interest charge, cash advance fee, foreign transaction fee, late payment/NSF fees, or other fee, even if the fee was bona fide and reasonable (for credit cards) or otherwise not included in the MAPR calculation (such as a late fee) anytime there is “no balance” in an account. “No balance” appears to mean that the average daily balance for the cycle is zero or negative. A zero (or negative) balance could arise in several circumstances, for example, if a consumer makes a payment substantially larger than the outstanding balance. In addition, a zero balance could occur if a consumer returns merchandise the month after it was purchased (and paid for) and gets a “credit” for the amount of the transaction in a subsequent cycle. Similarly, a consumer could dispute a paid transaction and receive a credit in a later cycle if the creditor determines there was a billing error. In these and other circumstance, the average balance in an account could be zero, even though the consumer makes a purchase or takes a cash advance in the same cycle in which a fee is charged. Modifying the rule to apply only if there is no balance for every day in the billing cycle would avoid these anomalies

Third, limiting the “safe harbor” for charging a participation (or application) fee only when a balance is “zero” has the effect of prohibiting such fees if a covered borrower has a low balance in the billing cycle in which that fee is charged. This is because assessing such a fee when there is a low balance would cause the MAPR to exceed 36%. This creates the anomaly of permitting a participation fee if there is no balance in the billing cycle, but prohibiting such a fee if there is a “small” balance in the cycle. The result seems contrary to the intent to permit reasonable participation fees when there is no balance in the cycle in which the fee is charged.

- **Proposed Solution:** Section 232.4(c)(1)(iv) should be modified by adding “(A)” after the heading, and by adding a semicolon and the word “and” at the end of that subparagraph.
 - A new subparagraph (B) should be added to section 232.4(c)(1)(iv) to read:

(B) Notwithstanding the requirements of this section 232.4(c), a creditor is not required to include in the MAPR an application fee or a fee for participation in any plan or arrangement for an open-end credit provided that fee does not exceed \$100 per annum, regardless of the billing cycle in which the fee is charged; however, this \$100 limitation does not apply to credit card plans.
 - Section 232.4(c)(2)(ii)(B) should be modified to read:

(B) *No balance or negative balance during a billing cycle.* For open-end credit, if ~~the MAPR cannot be calculated in a billing cycle because~~ there is no balance **or a negative** balance **for every day** in ~~a~~**the** billing cycle, a creditor may not impose any fee or charge during that billing cycle **that must be included in the MAPR**, except that the creditor may impose **an application fee or** a fee for participation in any plan or arrangement for that open-end credit so long as the **application or** participation fee does not exceed \$100-per annum, regardless of the billing cycle in which the **application or** participation fee is imposed; *provided, however,* that the \$100-per annum limitation on the amount of **an application or** participation fee does not apply to a bona fide **application or** participation fee imposed in accordance with paragraph (d) of this section.