

## LAW REVIEW 13162

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## Predatory Lending: Service Members Get New Protections from some Loan Practices<sup>1</sup>

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### 9.0--Miscellaneous

“DO NOT BLOW YOUR FIRST PAYCHECK ON A DOWN PAYMENT FOR A CAR.” This advice was imparted to me (Swerling) by my Sergeant Instructors at Officer Candidate School, because imprudent borrowing and spending is such a problem in the military. Aggressive lenders prey on service members, especially young ones, with unconscionable car title and payday loans. A 2006 study by the Department of Defense (DoD) found the practice of taking and rolling over payday loans to be so pervasive and detrimental that it “undermines military readiness, harms the morale of troops and their families, and adds to the cost of fielding an all-volunteer fighting force.”

In response to the 2006 DoD study, Congress passed the Military Lending Act in 2007. The legislation was designed to protect service members and their dependents from predatory lenders. The law was then amended in January 2013 to strengthen the protections in the original law.<sup>3</sup>

This law applies to persons on active duty, including Reserve Component (RC) members on orders for at least 30 days, and to their dependents. Under the law, creditors are prohibited from charging any military consumer interest greater than 36 percent annual percentage rate. This includes all the cost elements associated with the extension of credit, including fees, service charges, renewal charges, credit insurance premiums, any ancillary product sold with any extension of credit, and any other charge or premium with respect to the extension of consumer credit. This provision of the law is designed to prevent creditors from advertising a low interest rate and then hiking it up with hidden charges and fees.

Additionally, the following “predatory lending” practices are illegal regarding loans to a military consumer:

- Creditors cannot “roll over” or refinance the same loan between the same creditor and borrower.

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<sup>1</sup> This article is an update of Law Review 0742, published in September 2007 and written by Lieutenant Commander Ted Cook, JAGC, USN. We have been unable to locate him, but we believe that he is still on active duty or in the Navy Reserve. We have updated his rank to Commander since it is likely that he has been promoted since 2007.

<sup>2</sup> Military titles are shown for identification only. The views expressed herein are the views of the authors and should not be attributed to the Navy, the Marine Corps, the Department of Defense, or the United States Government.

<sup>3</sup> For the 2013 amendments see Sections 661, 662, and 663 of the National Defense Authorization Act for Fiscal Year 2013.

- Creditors cannot require borrowers to waive any state or federal law, including provisions of the Servicemembers Civil Relief Act.
- Creditors cannot require borrowers to submit to arbitration or other onerous legal notice provisions.
- Creditors cannot require a borrower to issue a check as a means of access to the borrower's financial accounts or require a borrower to provide a vehicle title as loan security.
- Creditors cannot insert into credit agreements any unreasonable notice requirement as a prerequisite to the consumer's right to bring legal action against the creditor.
- Creditors cannot require a borrower to create a voluntary allotment for the benefit of the creditor as a loan prerequisite.
- Creditors cannot charge a penalty for prepayment of a loan, in whole or in part.

The law provides that:

**(a) Interest.**--A creditor who extends consumer credit to a covered member of the armed forces or a dependent of such a member shall not require the member or dependent to pay interest with respect to the extension of such credit, except as--

- (1) agreed to under the terms of the credit agreement or promissory note;
- (2) authorized by applicable State or Federal law; and
- (3) not specifically prohibited by this section.

**(b) Annual percentage rate.**--A creditor described in subsection (a) may not impose an annual percentage rate of interest greater than 36 percent with respect to the consumer credit extended to a covered member or a dependent of a covered member.

**(c) Mandatory loan disclosures.**--

**(1) Information required.**--With respect to any extension of consumer credit (including any consumer credit originated or extended through the internet) to a covered member or a dependent of a covered member, a creditor shall provide to the member or dependent the following information orally and in writing before the issuance of the credit:

- (A) A statement of the annual percentage rate of interest applicable to the extension of credit.
- (B) Any disclosures required under the Truth in Lending Act ([15 U.S.C. 1601 et seq.](#)).

**(C) A clear description of the payment obligations of the member or dependent, as applicable.**

**(2) Terms.**--Such disclosures shall be presented in accordance with terms prescribed by the regulations issued by the Board of Governors of the Federal Reserve System to implement the Truth in Lending Act ([15 U.S.C. 1601 et seq.](#)).

**(d) Preemption.**--

**(1) Inconsistent laws.**--Except as provided in subsection (f)(2), this section preempts any State or Federal law, rule, or regulation, including any State usury law, to the extent that such law, rule, or regulation is inconsistent with this section, except that this section shall not preempt any such law, rule, or regulation that provides protection to a covered member or a dependent of such a member in addition to the protection provided by this section.

**(2) Different treatment under State law of members and dependents prohibited.**--States shall not--

**(A)** authorize creditors to charge covered members and their dependents annual percentage rates of interest for loans higher than the legal limit for residents of the State; or

**(B)** permit violation or waiver of any State consumer lending protections for the benefit of residents of the State on the basis of nonresident or military status of a covered member or dependent of such a member, regardless of the member's or dependent's domicile or permanent home of record.

**(e) Limitations.**--It shall be unlawful for any creditor to extend consumer credit to a covered member or a dependent of such a member with respect to which--

**(1)** the creditor rolls over, renews, repays, refinances, or consolidates any consumer credit extended to the borrower by the same creditor with the proceeds of other credit extended to the same covered member or a dependent;

**(2)** the borrower is required to waive the borrower's right to legal recourse under any otherwise applicable provision of State or Federal law, including any provision of the Servicemembers Civil Relief Act;

**(3)** the creditor requires the borrower to submit to arbitration or imposes onerous legal notice provisions in the case of a dispute;

**(4)** the creditor demands unreasonable notice from the borrower as a condition for legal action;

**(5)** the creditor uses a check or other method of access to a deposit, savings, or other financial account maintained by the borrower, or the title of a vehicle as security for the obligation;

**(6)** the creditor requires as a condition for the extension of credit that the borrower establish an allotment to repay an obligation; or

**(7)** the borrower is prohibited from prepaying the loan or is charged a penalty or fee for prepaying all or part of the loan.

**(f) Penalties and remedies.--**

**(1) Misdemeanor.**--A creditor who knowingly violates this section shall be fined as provided in title 18, or imprisoned for not more than one year, or both.

**(2) Preservation of other remedies.**--The remedies and rights provided under this section are in addition to and do not preclude any remedy otherwise available under law to the person claiming relief under this section, including any award for consequential and punitive damages.

**(3) Contract void.**--Any credit agreement, promissory note, or other contract prohibited under this section is void from the inception of such contract.

**(4) Arbitration.**--Notwithstanding section 2 of title 9, or any other Federal or State law, rule, or regulation, no agreement to arbitrate any dispute involving the extension of consumer credit shall be enforceable against any covered member or dependent of such a member, or any person who was a covered member or dependent of that member when the agreement was made.

**(5) Civil liability.--**

**(A) In general.**--A person who violates this section with respect to any person is civilly liable to such person for--

**(i)** any actual damage sustained as a result, but not less than \$500 for each violation;

**(ii)** appropriate punitive damages;

**(iii)** appropriate equitable or declaratory relief; and

**(iv)** any other relief provided by law.

**(B) Costs of the action.**--In any successful action to enforce the civil liability described in subparagraph (A), the person who violated this section is also liable for the costs of the action, together with reasonable attorney fees as determined by the court.

**(C) Effect of finding of bad faith and harassment.**--In any successful action by a defendant under this section, if the court finds the action was brought in bad faith and for the purpose of harassment, the plaintiff is liable for the attorney fees of the defendant as determined by the court to be reasonable in relation to the work expended and costs incurred.

**(D) Defenses.**--A person may not be held liable for civil liability under this paragraph if the person shows by a preponderance of evidence that the violation was not intentional and resulted from a bona fide error notwithstanding the maintenance of procedures reasonably adapted to avoid any such error. Examples of a bona fide error include clerical, calculation, computer malfunction and programming, and printing errors, except that an error of legal judgment with respect to a person's obligations under this section is not a bona fide error.

**(E) Jurisdiction, venue, and statute of limitations.**--An action for civil liability under this paragraph may be brought in any appropriate United States district court, without regard to the amount in controversy, or in any other court of competent jurisdiction, not later than the earlier of--

(i) two years after the date of discovery by the plaintiff of the violation that is the basis for such liability; or

(ii) five years after the date on which the violation that is the basis for such liability occurs.

**(6) Administrative enforcement.**--The provisions of this section (other than paragraph (1) of this subsection) shall be enforced by the agencies specified in section 108 of the Truth in Lending Act ([15 U.S.C. 1607](#)) in the manner set forth in that section or under any other applicable authorities available to such agencies by law.

**(g) Servicemembers Civil Relief Act protections unaffected.**--Nothing in this section may be construed to limit or otherwise affect the applicability of section 207 of the Servicemembers Civil Relief Act ([50 U.S.C. App. 527](#)).

**(h) Regulations.**--(1) The Secretary of Defense shall prescribe regulations to carry out this section.

(2) Such regulations shall establish the following:

(A) Disclosures required of any creditor that extends consumer credit to a covered member or dependent of such a member.

(B) The method for calculating the applicable annual percentage rate of interest on such obligations, in accordance with the limit established under this section.

(C) A maximum allowable amount of all fees, and the types of fees, associated with any such extension of credit, to be expressed and disclosed to the borrower as a total amount and as a percentage of the principal amount of the obligation, at the time at which the transaction is entered into.

(D) Definitions of "creditor" under paragraph (5) and "consumer credit" under paragraph (6) of subsection (i), consistent with the provisions of this section.

(E) Such other criteria or limitations as the Secretary of Defense determines appropriate, consistent with the provisions of this section.

(3) In prescribing regulations under this subsection, and not less often than once every two years thereafter, the Secretary of Defense shall consult with the following:

- (A) The Federal Trade Commission.
- (B) The Board of Governors of the Federal Reserve System.
- (C) The Office of the Comptroller of the Currency.
- (D) The Federal Deposit Insurance Corporation.
- (E) Bureau of Consumer Financial Protection.
- (F) The National Credit Union Administration.
- (G) The Treasury Department.

**(i) Definitions.**--In this section:

- (1) **Covered member.**--The term “covered member” means a member of the armed forces who is--
  - (A) on active duty under a call or order that does not specify a period of 30 days or less; or
  - (B) on active Guard and Reserve Duty.
- (2) **Dependent.**--The term “dependent”, with respect to a covered member, means a person described in subparagraph (A), (D), (E), or (I) of section 1072(2) of this title.
- (3) **Interest.**--The term “interest” includes all cost elements associated with the extension of credit, including fees, service charges, renewal charges, credit insurance premiums, any ancillary product sold with any extension of credit to a servicemember or the servicemember's dependent, as applicable, and any other charge or premium with respect to the extension of consumer credit.
- (4) **Annual percentage rate.**--The term “annual percentage rate” has the same meaning as in section 107 of the Truth and Lending Act (15 U.S.C. 1606), as implemented by regulations of the Board of Governors of the Federal Reserve System. For purposes of this section, such term includes all fees and charges, including charges and fees for single premium credit insurance and other ancillary products sold in connection with the credit transaction, and such fees and charges shall be included in the calculation of the annual percentage rate.
- (5) **Creditor.**--The term “creditor” means a person--
  - (A) who--
    - (i) is engaged in the business of extending consumer credit; and
    - (ii) meets such additional criteria as are specified for such purpose in regulations prescribed under this section; or
  - (B) who is an assignee of a person described in subparagraph (A) with respect to any consumer credit extended.
- (6) **Consumer credit.**--The term “consumer credit” has the meaning provided for such term in regulations prescribed under this section, except that such term does not include (A) a residential mortgage, or (B) a loan procured in the course of purchasing a car or other personal property, when that loan is offered for the express purpose of financing the purchase and is secured by the car or personal property procured.

United States Code Title 10 Section 987.