Credit Card Issuers, Be Warned: The Military Lending Act is on its Way

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As most creditors now know, the recent expansion of the Military Lending Act ("MLA") became effective in October of 2016. The Final Rule was originally published on July 22, 2015. In addition, the Department of Defense ("DOD") published interpretive guidance on August 29, 2016-little more than a month before the effective date. However, "credit extended in a credit card account under an open-end (not home-secured) consumer credit plan" maintains a temporary exemption from coverage until October 3, 2017. Moreover, the DOD retained authority to potentially extend that exemption for another year, meaning that credit cards may not even be included within the definition of "consumer credit" under the MLA until as late as October 3, 2018. Despite the delayed coverage date, we suggest that credit card providers start preparing now.

Many creditors found themselves rushing at the last minute to comply with the MLA's burdensome requirements, including oral and written disclosure requirements and determination of covered borrower status. After the exemption expires, not only will all of the MLA's provisions apply to credit card products, but such lines of credit will also be subject to additional requirements, which are even more complicated.

Of particular note among the MLA's provisions is the imposition of the 36% Military Annual Percentage Rate ("MAPR") cap. The MAPR is an all-inclusive APR that doesn't recognize some "finance charge" exceptions under Regulation Z. For example, the MAPR calculation must include charges for voluntary credit insurance, debt cancellation contracts, debt suspension agreements, and ancillary products sold in connection with the credit. In addition, and perhaps most significantly for credit cards, the MAPR also includes charges such as application fees and participation fees.

Imposing the 36% MAPR rate cap on credit card products means that in transactions with covered borrowers, creditors will be required to calculate and comply with the MAPR limit every billing cycle. Creditors will be permitted to waive excess fees in a billing cycle to avoid exceeding the MAPR cap, but doing so may be difficult for most creditors without significant preplanning.

Alternatively, the DOD crafted an exemption from the MAPR calculation for certain fees. Under this unique exemption for credit card products, creditors may exclude certain fees from the MAPR, if the fees are "bona fide" and "reasonable for that type of fee." To determine whether a fee is "reasonable," the DOD permits creditors to compare a specific fee to fees typically imposed by other creditors for the same or a substantially similar product or service. The DOD developed a

somewhat contrived "voluntary safe harbor" for determining whether a fee is reasonable, as follows:

[Such fee is reasonable] if the amount of the fee is less than or equal to an average amount of a fee for the same or a substantially similar product or service charged by 5 or more creditors each of whose U.S. credit cards in force is at least $3 billion in an outstanding balance (or at least $3 billion in loans on U.S. credit card accounts initially extended by the creditor) at any time during the 30 year period preceding the time such average is computed.

Though accessing the information to make these comparisons may seem daunting, according to the DOD, creditors need not worry. The DOD "believes that all creditors who offer credit card products…could readily calculate whether each type of fee associated with those products may fit within the safe harbor," and that such information is "widely available." According to the DOD, credit card issuers often make their fees available on their websites, and, in some cases, are required to do so. Moreover, creditors can pull public SEC filings to determine such information. Whether these methods for accessing the information required by the safe harbor are realistic remains to be seen. However, the good news is that creditors are permitted to rely upon commercially compiled information to determine whether a fee satisfies the "reasonableness" safe harbor requirements.

Significantly, if a creditor charging a finance charge to a covered borrower imposes any fee that is not a bona fide fee, then the total amount of those fees, including any bona fide fees and other finance charges, must all be included in the MAPR calculation. In other words, if a creditor imposes three bona fide and reasonable fees, and one bona fide, but unreasonable fee, all four fees must then be included in the MAPR calculation, potentially resulting in a violation of the MAPR cap.

Despite the unsettled analysis for determining whether a fee is "reasonable," credit card providers should be aware that the cost of noncompliance is draconian. The MLA's civil penalties include having the credit transaction declared void from inception, actual damages, punitive damages, equitable or declaratory relief, court costs, and attorney's fees. Knowing violations trigger criminal penalties.

Unfortunately, the bona fide and reasonable fee standard is only one of the technical and logistical issues creditors must resolve before the current exemption expiration date of October 3, 2017. Accordingly, though the timeline may still seem lengthy and uncertain, credit card issuers would be wise to start developing and testing their MLA compliance policies and procedures well in advance of the effective date.

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