
CONSUMER FINANCE PODCAST – MILITARY LENDING ACT AND SERVICEMEMBERS CIVIL RELIEF ACT OVERVIEW**HOST: CHRIS WILLIS****GUEST: TONY KAYE****AIRD: AUGUST 4, 2022****[CHRIS WILLIS]**

Welcome to the *Consumer Finance Podcast*. I'm your host Chris Willis, the co-practice leader of Troutman Pepper's Consumer Financial Services Regulatory Group. And we have a great episode for you today about service member protection in the consumer financial services industry. But before we jump into that, let me remind you to visit and subscribe to our blog at ConsumerFinancialServicesLawMonitor.com where we post new material every day about current goings-on in the consumer finance industry. And don't forget to check out our other podcast *FCRA Focus* which is released monthly on all popular podcast platforms. And if you like our podcast, let us know. Leave us a review on the podcast platform of your choice. So, as I said, today we're going to be talking about the protection of members of the military and their dependents under two key federal statutes, the Military Lending Act and the Servicemembers Civil Relief Act. And we have a great guest to tell you all about that, which is my partner Tony Kaye, who is in Salt Lake City, and is our expert on all things Military Lending Act and SCRA. So Tony, welcome to the podcast.

[TONY KAYE]

Thank you, Chris. It's good to be here.

[CHRIS WILLIS]

So, let's just set the background for the audience first. Can you just give us a brief description of like, what is the difference between and what is covered by the MLA, the Military Lending Act, and the Servicemembers Civil Relief Act.

[TONY KAYE]

Both, in general, protect active duty servicemembers. That's not the big difference between them. But what is different is that the Servicemembers Civil Relief Act was enacted to protect people who go on to active duty who might not, who weren't on active duty before. So, you know, let's say you are in the National Guard, and you get activated. So now, all of a sudden, you are sent to a foreign country or on active duty, all of your financial obligations now get subjected to the SCRA and it's 6% rate limitation. That's intended to protect you from sort of the unexpected financial problems that a servicemember might encounter when called to active duty. The Military Lending Act, by contrast, was initially intended to deal more with predatory lending. So, payday loans and that sort of thing. But it was expanded, as most people know, in 2015, to cover a much broader spectrum of financial products. The Military Lending Act, by contrast, applies to servicemembers who apply for credit while they are already on active duty. So, it doesn't give them as strong a protection, right, the cap under the Servicemembers Civil Relief Act is 6%, that's a real big drop if you got surprised and were sent overseas as compared to the restrictions under the Military Lending Act, which basically protect you from any interest rates over 36%. They both have different types of protections, the Servicemembers Civil Relief Act, which I will call SCRA on occasion if that is okay, it

protects against foreclosures, both of vehicles and of homes while you are on active duty with the idea being that while you're on active duty you don't want to have to worry about your house being foreclosed on and your family being thrown out on the street. And it's generally intended to protect you from collection activities and that sort of thing, sort of surprise activities of your lenders while you are off fighting for your country. The Military Lending Act, by contrast, really protects you more in the context of loans that you take out while you are already on active duty. So, it protects you on the interest rate, it protects you from being forced to arbitrate, there's a strong prohibition in the Military Lending Act against arbitration which is consistent with the CFPB's dislike for arbitration in general. It's really intended, another great protection is, you know, you can't use your military allotments, you know, which is a way of setting aside money to pay things, like that that cannot be attached or used by lenders to make sure that you're paying your bills. You can't give them checks that are already written out. Those sorts of things. Both statutes are enforced with some vigor by the respective agencies responsible for them. In the case of the SCRA, that's the Department of Justice because the CFPB doesn't have authority to enforce the SCRA. However, the CFPB does examine concerning the SCRA and will report problems that it observes to the Department of Justice. And the Military Lending Act of course will now be enforced directly by the CFPB as a result of the revisions to the Dodd Frank Act.

[CHRIS WILLIS]

So, thanks for that Tony. And, although a lot of the conversation around servicemember protection revolves around the two federal statutes that you just mentioned, there are also state analogues to the Servicemembers Civil Relief Act or MLA. What do they add to our analysis when we think about servicemember protection?

[TONY KAYE]

The main thing that they add is that the SCRA and Military Lending Act, they're federal laws and they protect servicemembers when they're activated by the President. The main thing that gets added by these state laws is that, in the event a Governor of a particular state calls a state guard to duty, and so in those cases, most of the states have a law that will protect servicemembers who get activated to go to Florida to deal with clean up after a hurricane or, you know, to help with hurricane relief efforts. So, something like that, you'd be protected by the state laws and not necessarily the federal laws. Now a lot of the state laws are just mirror images of the federal laws, so as soon as the Governor issues a call to active duty for usually more than thirty (30) days, then you get all of the protections that you would have under the federal law. Some of the states have, you know, varying protection, some are higher, you get more protection than the federal government would give you. And some give you less.

[CHRIS WILLIS]

Okay. Thanks. So now that we know the legal landscape that we're operating in, let's talk about some of the key issues that have been percolating around servicemembers in the consumer finance industry for the past few years. The first one was one you mentioned in your introductory comments which is the protections against either having your house foreclosed on or your vehicle repossessed under the Servicemembers Civil Relief Act. Can you just tell the audience a little bit about what the issues are there that regulators have called out in the industry?

[TONY KAYE]

Well, this is a very basic issue and a very basic violation of the Servicemembers Civil Relief Act. One thing that lenders should just bear in mind with this problem is that before they foreclose either a car or a home, they have to run a scrub of the SCRA database and make sure that the home, that they intend to foreclose or the car that they intend to foreclose, is not owned by an active duty servicemember who's entitled to the protections of the SCRA. And you'd just be surprised at the number of lenders out there that don't follow that rule. I mean, the expectation of a lot of lenders has been that servicemembers will notify the lender that they're on active duty and as a practical matter, that hasn't worked. Even though the law says that you're supposed to notify the lender to invoke the protections of the SCRA. First of all, that's not really the case when it comes to foreclosures, but as a practical matter, the government hasn't treated it like it's the case. The government expects you, and this is based on a history of consent orders and as you know, rulemaking via enforcement, you need to affirmatively check these databases to make sure that you are giving servicemembers the protections that they're entitled to.

[CHRIS WILLIS]

So, on that topic, you know, you've talked about the necessity of conducting a scrub against the Department of Defense SCRA database before you go foreclosing on a house or repossessing a car, but let's talk about what issues have the regulators found with identifying eligible servicemembers on the other aspects of protection for both the SCRA and the Military Lending Act? Like the interest rate reduction for example.

[TONY KAYE]

The government has determined, in numerous cases, that a failure to conduct scrubs of the SCRA database has meant that there's been large numbers of people who are customers of a particular financial institution who have not gotten the benefit of the 6% rate cap. Now, the defense to those sorts of suits, you know back when this first started happening, was well, the servicemember didn't provide a copy of the orders that were necessary for us to implement this. And we didn't have to do it without it. That really hasn't flown. Another defense was, well, we obtained a copy of orders in our credit card department, but we didn't get a copy of those orders submitted in connection with the related auto loan. And so, we've had consent orders that have indicated that once you get as a company a set of orders or forget that, good enough information from the Army or the Navy or the Marines, that the person in question is on active duty then you need to apply the rate cap, not only to the account that you were notified about by the servicemember or that you are first aware of, but you need to check every account that that servicemember has with your institution and apply the 6% cap to all of them. So that may be a mortgage, may be an auto loan, may be a credit card account or personal loan. You just can't be finicky about how you implement the SCRA and if you are, the government will take issue with that.

[CHRIS WILLIS]

So, what about under the Military Lending Act? So, I think there has been some regulatory action around the perceived failure of certain types of consumer financial services companies to identify MLA-protected borrowers. Can you tell us a little bit more about that?

[TONY KAYE]

With respect to the MLA, where the government has focused with CIDs and you know other sorts of examinations, has been in the short term, small dollar lending arena. And in that space, you have lenders who are reluctant for one reason or another to avail themselves of the safe harbor allowed under the Military Lending Act. Safe harbor essentially requires you to run a check of the Military Lending Act database to see if your consumer is listed and, if that person is listed, then your loan needs to be compliant with the MLA and you need to save the documentation. Now for some businesses that's really inconvenient particularly in the small dollar lending industry. The small dollar lending industry usually just takes a, you know, a copy of a driver's license and some basic information on the person's identification, but they don't for instance, want to take social security numbers because, you know, there's a potential for the use of social security numbers, the maintenance of them in a database, to lead to a data breach where they could have broader liability. And so, these organizations, instead of getting a social security number and doing a check against the database, will do an MLA check the old-fashioned way, which is essentially just to ask the person who's coming in to take a loan out whether or not they are a member of the military on active duty or whether or not they are related to a member of the military on active duty. Now the downside of this is that you're risking not being told the truth by the servicemember because sometimes servicemembers want to be able to get a loan, a small dollar loan in particular, for one reason or another, and they know that if they are in the military that the small dollar lender won't make a loan to them because they're not gonna make a loan that's below the 36% rate cap. This has led to several CIDs and an enforcement action where the government's trying to figure out what percent of a small dollar lender's portfolio turns out to be members of the military who are on active duty and were entitled to the protections of the MLA. And the downside of course of the violation is that if the loan, if it's a small dollar loan and it's been made to a servicemember on active duty, it's most likely the interest rate provision that's been violated, if it's an arbitration agreement, that's the violation. And all of these violations make the underlying contracts sort of void from inception which means that the servicemember gets to keep the proceeds of the loan and get a return of collateral if they put up any collateral for the loan, that sort of thing.

[CHRIS WILLIS]

As our final sort of hot area Tony, I wanted to ask you about something where I feel like the industry has been in a lot of area of uncertainty for a long time. And that is the idea of the purchase money provision in the Military Lending Act that basically says it's not an MLA covered loan if it's a purchase money loan for an automobile. And then the back and forth about whether or not the addition of an optional product like gap coverage will render it a covered loan under the MLA or not. And I feel like there's been quite a bit of back and forth about that. Can you bring the listeners up to speed on where we stand on that issue now and is there any resolution in sight?

[TONY KAYE]

So, the two federal courts that have looked at this have decided that the exception in the statute, and also in the rule, for purchase money secured auto loans, applies notwithstanding this inclusion of gap coverage or something like a vehicle tracking device. I mean if the consumer has paid for gap coverage, that's just considered, by the courts at least, to be a, something that goes along with the sale of the car. It's no different than the optional red leather seats that the CFPB said early on would not change your analysis under whether or

not this exception applies. The CFPB disagrees vehemently and one of the cases is on appeal right now with the CFPB having filed an amicus brief on it. And that the CFPB's position is very similar to what its position was with the interpretative guidance actually, that it put out a couple of years ago and then withdrew. And the CFPB views sort of any ancillary product as being beyond the scope of what the exception under the Military Lending Act is for purchase money secured auto loans. And they want auto lenders to be extremely careful on how they write these loans. And if the loan is for anything more than the car, and I guess optional red leather seats or something that's affixed to the car but can't be used for any sort of foreclosure activity or repossession activity, those loans they would have covered by the MLA. And that's a lot of loans. The auto industry has been sort of up in arms over the last couple of years with many auto lenders not treating a loan that includes gap coverage or something like that as triggering the MLA. And if it turns out on appeal that they're wrong, the downside is that tons and tons of auto loans could be considered to be void *ab initio*. So, there's a lot riding on this. I don't think that it's a strong argument from the government's perspective. I do think if you look at the history of the Military Lending Act that it is really focused on predatory lending and it has a very, very straightforward exception for purchase money auto loans and for mortgages. And if you allow the government here to come up with a sort of work around that brings, would bring most auto finance transactions within the ambit of the MLA because most auto finance transactions do include some form of gap coverage and they do include various ancillary products, and things like negative equity financing. If you allow that, then it's gonna basically erase what Congress wrote when it drafted the MLA in the first place.

[CHRIS WILLIS]

Well, it sounds like the practical sort of light at the end of the tunnel on this is waiting for the court of appeals ruling that you mentioned in the case where the CFPB submitted an amicus brief. Cause as far as I know, there's not any other like rule-making or other activity going on with respect to this, is there?

[TONY KAYE]

No, there's not. We're expecting a decision in that case probably in the next several months because it's, I believe, the case is fully briefed. So, it'll be very interesting to see what happens with that.

[CHRIS WILLIS]

So Tony, thanks very much for being on the podcast today and sharing your insights with respect to these very important servicemember protection issues. These remain an area of incredibly high priority for the regulators and, therefore, risk to members of the financial services industry, and so it's very important for us to remind everybody about those. And let me of course also thank our listeners for tuning in to today's episode. Don't forget to visit us at our blog ConsumerFinancialServicesLawMonitor.com and hit that subscribe button so that you can get our updates about all the news that's going on in the consumer financial services universe. And go to our website at troutman.com, add yourself to our consumer financial services email list so you can get copies of our alerts and invitations to our webinars for members of the industry. And, of course, be sure to stay tuned for a great new episode of this podcast every Thursday. Thank you all for listening.

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