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***The Consumer Finance Podcast – MLA and SCRA 102: Pricing Constraints and the Complexity of Interest Cap Compliance — Servicemember Protections Explained***

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**Guests:** Jeremy Sairsingh, Taylor Gess

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**Chris Willis (00:05):**

Welcome to [The Consumer Finance Podcast](#). I'm Chris Willis, the co-leader of Troutman Pepper Locke's Consumer Financial Services Regulatory Practice. And today we're going to be talking about how the Military Lending Act and the Servicemembers Civil Relief Act can impose restrictions on product design even before a product is launched. But before we jump into that very interesting topic, let me remind you to visit and subscribe to our blogs, [TroutmanFinancialServices.com](#) and [ConsumerFinancialServicesLawMonitor.com](#). And be sure to give our other podcasts a listen. We have [Payments Pros](#), [Moving the Metal](#), [The Crypto Exchange](#), and [FCRA Focus](#). Those are all available on all popular podcast platforms. And speaking of those platforms, if you like this podcast, let us know. Leave us a review on your platform of choice and tell us how we're doing. Now, as I said today, this is another one of our continuing series of episodes on service member protection statutes, principally the Servicemembers Civil Relief Act and the Military Lending Act. And joining me again for this next episode are my colleagues Taylor Gess and Jeremy Sairsingh. Taylor, Jeremy, thanks for coming back. I can't wait for this episode.

**Taylor Gess (01:09):**

Yeah, thanks for having us, Chris.

**Chris Willis (01:11):**

So a lot of people think of these two statutes as ones that they need to worry about in servicing once they encounter a protected borrower. So someone goes on to active duty, they need to be given their benefits under the SCRA, et cetera. But the point that you want to convey to our audience today is that really this is a set of statutes that imposes constraints on the design of a product because in order to allow it to comply later on down the road, you really need to take these statutes into consideration in design. Can you talk about why that is the case?

**Jeremy Sairsingh (01:45):**

Sure. So both the MLA and the SCRA have pricing restrictions; the 6% cap on pre-service obligations under the SCRA and the 36% MAPR cap under the MLA. These operate as more than just legal rules. I think they present important product design constraints that can be more complex than, say, a state usury cap. By analogy, say you have a lender who is subject to state usury caps. A given state is capping interest at 16%. The lender says, "Well, for that geography, we will just cap interest at 16%." I think there's a temptation to treat service member populations like geographies. As to covered borrowers or SCRA-covered service members, we will cap

interest accordingly. And that approach can quickly break down because these statutes require asking a number of follow-up questions. So sure, we have a 6% or 36% restriction. But product teams have to answer a whole bunch of other questions: 6% of what? 36% of what? To what balance does this apply? To which customers? At what point? In which billing cycles? Which fees? What happens if the borrower goes into default? Or what if the borrower, say, requests SCRA benefits six months after going on active duty and then the benefit has to be applied retroactively? What if there are multiple accounts? These are all run-of-the-mill situations that lenders encounter when dealing with service members. And if you don't contemplate them from the get-go at the product design stage, you can be really setting yourself up for a lot of friction down the line.

**Chris Willis (03:17):**

Thanks, Jeremy. And a lot of this, in my perception, revolves around the fact that each of these statutes, the SCRA and the Military Lending Act, has their own definition of interest that differs from what we would classically consider interest under, say, a state usury statute or Truth in Lending or something like that. So let's start with the Servicemembers Civil Relief Act. What is SCRA interest for the purpose of applying the 6% cap that a person who goes on to active duty is entitled to?

**Jeremy Sairsingh (03:45):**

So to explain the cap briefly, the SCRA requires reducing interest on pre-service obligations to 6% after receiving proper notice, as described in the statute, for the duration of military service. So pre-service means incurred before military service, either by the service member or, in some cases, jointly by the service member and his or her spouse. One of the big questions here: What is interest for purposes of that 6% cap? It's not just the contract rate. It's not the APR as might be defined under Reg Z. To quote the statute, interest includes service charges, renewal charges, fees, or any other charges except for bona fide insurance with respect to an obligation or a liability. That's a really broad definition. And that phrase "with respect to" has been interpreted especially broadly by federal regulators. So while fees aren't automatically banned, they need to be analyzed as part of the SCRA interest cap when designing a product with respect to a covered obligation. For example, say the contract rate on a loan is 5%. That still requires factoring in the SCRA because a single fee could easily push you over that 5% limit up above the 6% cap. Another key question under the SCRA is when does that interest cap apply? Essentially, once the creditor determines that the cap applies, the statute requires reducing retroactively the rate on the customer's debts as of the date when they were called into military service or, importantly in the case of a reservist, the date on which the service member received his or her orders. The cap applies for the full duration of military service for most covered obligations, an important exception being mortgage-like obligations where it extends for one year past service. Critically, amounts of interest above 6% are forgiven; they're not deferred. So the payment has to be reduced retroactively to account for reduced amounts of interest.

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**Chris Willis (05:44):**

Jeremy, thanks. And so I assume that means that when you're designing a product, you have to understand which fees or aspects of the product are covered interest and which ones aren't, and the system of record needs to be able to turn the ones off that need to be turned off in order to comply with the 6% cap, right?

**Jeremy Sairsingh (06:01):**

Correct. What becomes essential as part of that analysis is looking at the underlying credit product and tuning those adjustments for the type of credit that you're dealing with. So for open and closed-end credit, the core rules apply to both, but the practical treatment of how you implement the SCRA cap differs depending on the product. So take closed-end credit, an installment loan for example, there, the creditor has to essentially recast the payment schedule from the start of the eligibility period, so going back to the date on which coverage would start for the service member and then re-amortizing the loan, thereby reducing the payment. So the result should be that the payment amount comes down by the amount of the forgiven interest. It's basically as if the reduced rate had been the contract rate from the time the customer became eligible. Similarly with fees, if there are fees on the account, those need to be considered. Do they need to be waived? Can this fee be charged without exceeding the 6% cap? Then, say you have a credit card or line of credit product or some other open-end product, this raises other considerations that are less relevant in the closed-end world. For example, I mentioned earlier that the SCRA interest rate cap applies to pre-service obligations, so you might have a customer that incurred debt on a credit card prior to going on active duty. Charges incurred after going onto active duty are not necessarily protected by the 6% cap. So being able to segment out those balances can be really important depending on the product. When it comes to fees, annual fees, transaction fees, penalty fees, participation fees, figuring how fees post across billing cycles, these are all issues that go beyond just the advertised APR or the contract rate. And the interplay between draw dates or balance dates, the fee date, the military service date, can all add complexity to implementing this cap.

**Chris Willis (07:58):**

That does actually sound quite complex and very involved from the standpoint of programming a system of record to do what you just described, Jeremy. But I don't want to give the SCRA all the limelight in this episode. Let's talk about the Military Lending Act too. And Taylor, let me go to you for that. As consumer credit lawyers, we orient our lives around the definition of APR that's in the Truth in Lending Act, but the Military Lending Act has a different APR concept. Would you mind telling the audience about it?

**Taylor Gess (08:25):**

Sure, Chris. So the Military Lending Act likes to keep us on our toes and shake us of that habit of thinking about everything in terms of TILA and Reg Z. So the MLA has a 36% limit on the military APR, MAPR, that applies if you are a covered borrower or dependent of a covered borrower at the time the closed-end credit is extended or the open-end account is established. So the MAPR is similar to an APR under TILA and Reg Z, but it's more encompassing because it includes charges that are not finance charges under Reg Z when you calculate the MAPR. So

that MAPR calculation includes fees for credit-related ancillary products, credit insurance premiums, and fees for debt cancellation or debt suspension contracts. And subject to a bona fide fee exception that gets a little tricky that we'll discuss more in a minute, finance charges under Reg Z, application fees, and participation fees also all count towards the MAPR calculation. Bottom line, Chris, is just because a charge does not count towards the TILA/Reg Z APR, that doesn't mean that it's excluded from the MAPR.

**Chris Willis (09:31):**

That makes sense. And there's specific provisions in Reg Z that say if the ancillary product is voluntary and disclosed as such, it's not part of the finance charge. None of that matters for the purpose of the MAPR, does it?

**Taylor Gess (09:41):**

That's right, Chris. None of that matters.

**Chris Willis (09:43):**

You hinted at a bona fide fee exception. What does that cover?

**Taylor Gess (09:47):**

So, Chris, the bona fide fee exception, this applies if a card is a CARD Act credit card under Reg Z, and it allows issuers to charge reasonable bona fide fees that can be excluded from the MAPR calculation. I think this raises one of our favorite questions, Chris, what is reasonable? What does that mean, right? And so this determination is made by analyzing what fees are typically imposed in the market by other creditors for similar services or products. The first key part of what is reasonable then, Chris, that means that it needs to be an apples-to-apples type of comparison. So we're comparing like fees to like fees. We'd not, for example, compare a cash advance fee to a foreign transaction fee. And I think something that's really interesting about this is when the DOD did the final rule on this bona fide fee exception, it explained that this reasonable standard was intended to be applied flexibly. So they wanted creditors to be able to continue to offer a wide range of credit card products that carried reasonable costs that were tied to a specific product or service and that could have the ability to vary depending on what that fact-intensive inquiry that requires a comparison we're looking at for the similar product. So a similar type of fee on a card with similar credit limits, a similar scope of benefits, and similar target cardholders. And if that reasonable bona fide fee standard is not satisfied, then the creditor needs to include the total amount of that fee in the MAPR calculation.

**Chris Willis (11:16):**

Okay, that makes sense. And I guess to bring this back to the product design point, just as I talked about with Jeremy a moment ago, it seems like when you're designing a product, you need to have an understanding of how these other non-finance charge items might count towards the MAPR and how to calculate it to stay below the 36% cap, right?

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**Taylor Gess (11:37):**

Yeah, absolutely, Chris. So we live in a time of innovative product structure, and we love to help clients be creative. And thinking about this nuance of the MAPR and what fees are included and how that differs from the TILA APR they're calculating is really important. And just on that point, one way that the DOD guidance has said that creditors can comply with the MAPR's 36% cap is by limiting or reducing or otherwise waiving fees for covered borrowers that the agreement otherwise provides for.

**Chris Willis (12:09):**

Got it. Okay, so we've talked about the MAPR, we've talked about SCRA interest, but let's throw another wrinkle into this conversation, Jeremy, and talk about the no-acceleration provision of the Servicemembers Civil Relief Act. Tell the audience about what that is and then what practical impacts it has when we go to try to comply with the statute.

**Jeremy Sairsingh (12:28):**

I'll try to explain with an example here. So a really common scenario is the creditor will get an SCRA request from a borrower maybe six months or longer into service. So the customer's been making payments and now the lender has to go back and re-amortize the loan so that the rate was 6% or less as of the eligibility date. So we've got a customer who made, say, six months of full payments. What does the creditor do with that interest that now has to be forgiven? And this gets to the provision you mentioned, Chris. The SCRA prohibits acceleration of principal. So, interpreting this anti-acceleration of principal restriction in the SCRA, it's important not to read "no acceleration" too narrowly. It doesn't just mean calling the whole loan due. Rather, the statute requires the periodic payment be reduced by the amount of the forgiven interest that would be allocable to that period. So creditors might ask, "Can I just apply that forgiven interest to the customer's outstanding balance?" It seems intuitive. That would be paying down the customer's principal so that at the end of the loan term they'll have less interest accrued. Do I really need to give the customer a cash refund? Here, federal regulators have taken the position that applying the forgiven interest to the principal of the loan is only allowed after the customer is given the option to choose receiving a cash refund. Essentially, there has to be the ability, according to the FDIC, for example, of an affirmative election. And this ties back to the readiness purpose of the SCRA that we've discussed on a prior podcast. The idea is the service member should have the benefit of that reduced rate from the outset and the extra cash in his or her pocket that might entail. Having the rate reduced back to the eligibility date includes the option to receive a cash refund. But the customer could always elect, if given the choice, to have the paid excess interest applied to principal, which would reduce the outstanding balance on the loan.

**Chris Willis (14:33):**

Thanks a lot for the explanation, Jeremy, because I think that acceleration provision and the way that it works is not necessarily intuitive for all financial services companies, but nevertheless, that's the way the federal regulators have consistently interpreted it. So let me thank you for being on the episode today, and Taylor, you as well, for talking about this important topic. We do have one more episode coming in this special series about service

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member protections dealing with non-pricing protections, so please stay tuned for that. And thanks to our audience for listening today as well. As I reminded you at the beginning of the show, don't forget to visit and subscribe to our blogs, [TroutmanFinancialServices.com](https://www.troutmanfinancialservices.com) and [ConsumerFinancialServicesLawMonitor.com](https://www.consumerfinancialserviceslawmonitor.com). And while you're at it, why not visit us on the web at [troutman.com](https://www.troutman.com) and add yourself to our Consumer Financial Services email list? We send out a lot of great alerts and advisories to that email list, as well as invitations to our occasional industry-only webinars. And of course, stay tuned for a great new episode of this podcast hitting your podcast feed every Thursday afternoon. Thank you all for listening.

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