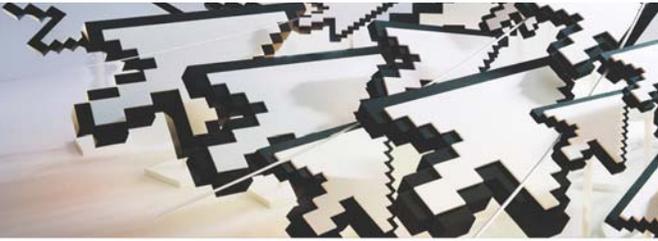


# Financial Services Regulatory Update



**September 14, 2016**

*This communication is designed to provide you with quick snapshots and timely perspectives on recent regulatory developments.*

## Meeting the Challenges of the Military Lending Act

### Background

On August 26, 2016 the U.S. Department of Defense issued an interpretive rule on the Military Lending Act (MLA), which becomes effective October 3, 2016. The interpretive rule addresses common industry questions regarding implementation challenges, and clarifies expectations regarding technical compliance and covered products, services and persons.

### Overview of the Guidance and Rule

In July 2015, the Department of Defense issued a final rule amending its regulation implementing the Military Lending Act. This final rule provides broader product coverage, extends protections to active duty servicemembers who enter into credit arrangements during active service, and modifies required disclosures, which must be provided both orally and in writing.

Among the key points contained in the guidance is a definition of *consumer credit*, intended to better align with Truth in Lending Act and Regulation Z definitions, although some exceptions are made for residential mortgage transactions, purchase money credit for a vehicle or personal property, and credit extended to non-covered borrowers. The MLA defines *consumer credit* as “Credit offered or extended to a covered borrower primarily for personal, family, or household purposes, and that is (i) subject to a finance charge or (ii) payable by a written agreement in more than four installments.” The MLA definitions for “closed-end” and “open-end” credit mirror those under the Truth in Lending Act. The following are examples of covered transactions:

- Open and Closed-end consumer credit, as defined under Regulation Z
- Overdraft lines of credit and many deposit advance products
- Credit cards not secured by the borrower’s home
- Purchase money auto or personal property loans that include a cash advance component (i.e., funds borrowed in excess of funds required to purchase the automobile or personal property)

Covered transactions carry a maximum rate – the Military Annual Percentage Rate (MAPR) – of 36%, which includes more than interest and other fees and costs typically considered finance charges. Now included in the calculation are:

- Fees such as application and annual participation charges, such as those associated with home equity lines of credit
- Fees and premiums for credit insurance, debt cancellation, and debt suspension
- Credit-related ancillary product fees for closed-end or open-end credit when those products are sold in connection with the credit transaction

Although certain fees and costs are excluded (e.g., bona fide transaction-based fees, if they are reasonable for that type of fee), a loan could quickly exceed the MAPR limit of 36% if it involves fees typical of smaller dollar loans.



## Compliance Challenges and Strategies

Financial services entities face implementation challenges and questions, some of which are addressed in the guidance but others of which remain unanswered in practical terms. Some of the outstanding questions include: whether loan origination systems can accurately calculate the new Military Annual Percentage Rate (MAPR), which fees and costs must be included in the MAPR calculation, making use of the safe harbor for those institutions that have access to the MLA database, and identifying covered borrowers. Adding to these challenges is the broadened definition of “covered persons,” the wider array of products covered, and the potential for failing to identify a covered borrower after a credit agreement is in place. Creditors must make every effort to ensure controls, systems and processes are ready for the mandatory compliance date.

### 1. Identifying Covered Transactions

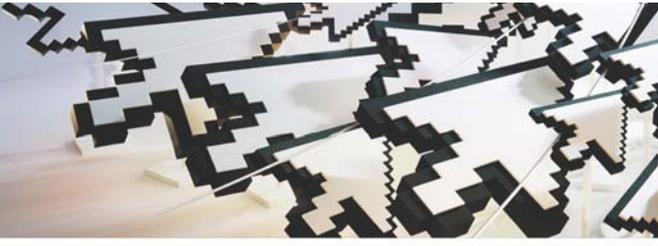
- Beginning with the products and services currently offered both directly (by the bank’s employees) and indirectly (through third party providers), determine which products are offered primarily for personal, family or household purposes
- Include deposit advance or overdraft programs covered by a written agreement that provides for the application of a periodic rate to balances
- Consider loans that include provisions for creating or pursuing direct access to a consumer deposit or other asset account, other than consumer-directed orders for periodic payments
- Before excluding purchase money loans for automobile or personal property, confirm such products do not permit advances in excess of the purchase amount (i.e., “cash-out” loans)

### 2. Identifying Covered Borrowers

- Develop and implement processes to facilitate direct options for determining whether a borrower is covered, including asking whether an individual is a servicemember and instructions for accessing the Department of Defense MLA Database (whether individually or in batches)
- Determine whether indirect sources for identifying covered borrowers are available to the bank, including credit report providers
- Test all processes for determining coverage for effectiveness, and include instruction and communication for personnel expected to use them
- Add records and documentation of the determination to the record retention schedule and verify records are retained as required

### 3. Determining MAPR Fees and Costs

- Beginning with customary fees and costs associated with consumer credit, determine which fees are covered under the MAPR requirements, including interest, finance charges as defined by Regulation Z, credit insurance or other ancillary fees
- Confirm fees are designated within all consumer loan origination systems (excluding residential real estate lending systems) as subject to MAPR inclusion

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- Determine the bank's strategy for avoiding fees and costs in excess of the MAPR limit (i.e., fee waivers, lower rates, lower fees, etc.)
  - Test systems to confirm all required fees are included, and covered transactions do not exceed the maximum of 36% of the credit amount

#### **4. Confirming Disclosures Comply**

- Determine the method the bank will use to make the required oral disclosure (provide a toll-free phone number on the application form or with MAPR disclosures, or instruct bankers to deliver a scripted statement)
- Include disclosures required by Regulation Z and a clear, concise description of the covered borrower's payment obligation (use the DOD's Model Statement or devise one materially similar)
- Review credit agreements and other loan documents to confirm they do not include prohibited provisions (e.g., waivers of right to legal recourse, onerous or unreasonable notice provisions, etc.)

#### **5. Testing Processes and Controls**

- Once compliance related determinations have been made and changes have been implemented, periodically test system and process performance to confirm MAPR accuracy, effective borrower coverage determination, and technical disclosure requirements for both regulatory and policy compliance
- Communicate action plans to specifically address any process gaps or weaknesses
- Include any recommended remediation in compliance tracking and reporting

#### **How Experis can help**

Experis Finance offers industry experience in all aspects of Financial Services, including:

- Assessing the adequacy of your organization's compliance control environment
- Developing internal MLA training programs to address unique risks
- Assisting in the development and/or enhancement of monitoring programs to detect compliance violations
- Developing and maintaining first, second, and third line control and transaction testing

Our Risk Advisory Services practice can evaluate your current loan compliance program, provide comprehensive recommendations for improvement and help address those recommendations.

Our team of professionals is experienced in working with clients to address these issues in order to help them avoid costly fines and penalties. If you have any questions about or concerns around your implementation of these steps, contact an Experis Finance representative at [financialservicesindustry@experis.com](mailto:financialservicesindustry@experis.com) or visit our website [Experis Finance](#).