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**October 8, 2007**

**Advisory Announcing the Department of Defense Final Rule on Limitations on Consumer Credit Extended to Service Members and Dependents**

The Department of Defense (DoD) has published the attached final rule that stipulates the terms of certain credit extensions to active duty service members and their dependents ("covered borrowers"). The rule applies to all persons engaged in the business of extending consumer credit and their assignees. The final rule applies to "consumer credit," which the DoD defines as "payday loans," "vehicle title loans" and "tax refund anticipation loans" that meet specific parameters. For these defined transactions with covered borrowers ("covered transactions"), the DoD rule:

- Limits interest to a 36 percent "military annual percentage rate (MAPR)" that comprises all fees and charges, including those for single premium credit insurance and other ancillary products sold in connection with the transaction; and
- Requires that certain oral and written loan disclosures be provided before the issuance of the covered transaction.

The DoD rule provides:

- The applicable consumer disclosures;
- The method for calculating the MAPR (as opposed to the Truth in Lending Act APR);
- The maximum amount and types of fees that may be charged; and
- A "safe harbor" for identifying covered borrowers, including a model borrower identification statement that creditors may use.

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The DoD rule prohibits:

- mandatory arbitration;
- waiver of legal rights;
- unreasonable notice requirements as a condition for legal action;
- payment by allotment; and
- prepayment penalties.

The rule further limits or restricts:

- rollovers and refinancings; and
- the use of a check or other method of access to a covered borrower's account.

Creditors offering any covered transactions are subject to criminal and civil penalties if they violate the rule. Moreover, consumer credit contracts that are not in compliance with the rule will be deemed void from inception.

The final rule went into effect on October 1, 2007. It applies to covered transactions that are consummated on or after that date. All creditors that offer any covered transactions are expected to be in full compliance by that date.

Attachment: Department of Defense, 32 C.F.R. Part 232, "Limitations on Terms of Consumer Credit Extended to Service Members and Dependents," Final Rule, http://a257.g.akamaitech.net/7/257/2422/01jan20071800/edocket.access.gpo.gov/2007/pdf/07-4264.pdf.

Federal Register

Friday,
August 31, 2007

# Part VI

# Department of Defense

32 CFR Part 232

**Limitations on Terms of Consumer Credit Extended to Service Members and Dependents; Final Rule**

**DEPARTMENT OF DEFENSE**

**Office of the Secretary**

**32 CFR Part 232**

**[DOD–2006–OS–0216]**

**RIN 0790–AI20**

## Limitations on Terms of Consumer Credit Extended to Service Members and Dependents

**AGENCY:** Department of Defense (DoD).

**ACTION:** Final rule.

**SUMMARY:** The Department of Defense (the Department or DoD) is amending 32 CFR by adding new regulations to implement the consumer protections provisions of Public Law 109–364, the John Warner National Defense Authorization Act for Fiscal Year 2007, section 670, "Limitations on Terms of Consumer Credit Extended to Service Members and Dependents" (October 17, 2006). Section 670 requires the Secretary of Defense to prescribe regulations to carry out the new section. The final rule regulates the terms of certain credit extensions to active duty service members and their dependents.

**EFFECTIVE DATE:** October 1, 2007.

**FOR FURTHER INFORMATION CONTACT:** Mr. George Schaefer, (703) 588–0876.

**SUPPLEMENTARY INFORMATION:**

### I. Background

Today's joint force combat operations require highly trained, experienced and motivated troops. We are fortunate that today's All Volunteer Force is comprised of individuals who fit the stringent requirements needed for success on the battlefield. The military has seen many changes since it became an All Volunteer Force in 1973. The technological advances over the ensuing 34 years have made remarkable transformations to the capabilities of the Armed Forces.

These advances would not have been as easily attained if it were not for the All Volunteer Force. The members of this force have higher levels of aptitude, stay in the military longer, and as a consequence, perform better than their conscript predecessors. During the Vietnam era draft, 90 percent of conscripts quit after their initial two-year hitch, whereas retention of volunteers is five-times better today—about half remain after their initial (four-year) military service obligation. Said another way, two thirds of the military was serving in its first two years of service prior to 1973, where as today, the number is about one-fourth.

Today's Service members are still younger than the population as a whole, with 46 percent 25 years old or less. Thirty-eight percent of Service members 25 years old or less are married and 21 percent of them have children. This is compared with approximately 13 percent of their contemporaries in the U.S. population 18 through 24 who are married (2000 Census). The majority of recruits come to the military from high school, with little financial literacy education.

The initial indoctrination provided to Service members is critical, providing basic requirements for their professional and personal responsibilities and their successful adjustment to military life. Part of this training is in personal finance, which is an integral part of their personal, and often, professional success. The Department of Defense (the Department) continues to provide them messages to save, invest, and manage their money wisely throughout their career.

Service members and their families are experiencing the sixth year of the Global War on Terror. The Department views the support provided to military families as essential to sustaining force readiness and military capability. From this perspective, it is not sufficient for the Department to train Service members on how best to use their financial resources. Financial protections are an important part of fulfilling the Department's compact with Service members and their families.

### Social Compact

The Department believes that assisting Service members with their family needs is essential to maintaining a stable, motivated All Volunteer Force. As part of the President's February 2001 call to improve the quality of life for Service members and their families, the Department developed a social compact reflecting the Department's commitment to caring for their needs as a result of their commitment to serving the Nation. The social compact involved a bottom-up review of the quality-of-life support provided by the Department, which articulated the linkage between quality-of-life programs as a human capital management tool and the strategic goal of the Department—military readiness.

The social compact is manifested in the programs the Department provides to support the quality of life of Service members and their families. This social compact includes personal finances as an integral part of their quality of life. The Department equates financial readiness with mission readiness. When asked in 2005 on a blind survey to rate the stressors in their lives, Service members (as a group) rated finances as a more significant stressor than deployments, health concerns, life events, and personal relationships. They only rated work and career concerns as a higher stressor in their lives. As part of the social compact for financial readiness, the Department established a strategic plan to:

- Reduce the stressors related to financial problems. The stress associated with out-of-control debt impacts the performance of Service members and has a major negative impact on family quality of life.
- Increase savings. Establishing personal and family goals, helps motivate Service members to control their finances and live within their means.
- Decrease dependence on unsecured debt. This reduces the stressors and vulnerabilities associated with living from paycheck to paycheck.
- Decrease the prevalence of predatory practices. This provides protection from financial practices that seek to deceive Service members or take advantage of them at a time of vulnerability.

The Department has taken action to obtain these outcomes by providing financial awareness, education, and counseling programs; by advocating the marketplace deliver beneficial products and services; and by advocating for the protection for Service members and their families from harmful products and practices.

### Financial Education

The Military Services are expected to provide instruction and information to fulfill the needs of Service members and their families. To this end, the Department established a policy in November 2004: DoD Instruction 1342.27, *Personal Financial Management Programs for Service Members.*

As outlined in the Government Accountability Office (GAO) Report 05–348, the Military Services have their own programs for training first-term Service members on the basics of personal finance. These programs vary in terms of venue and duration; however, all Military Service programs must cover the same core topics to the level of competency necessary for first-term Service members to apply basic financial principles to everyday life situations.

The Department has tracked the ability of Service members to pay their bills on time as a reflection of their competency and ability to apply basic financial principles. Since 2002, self-

reported assessments through survey data have shown Service members are doing a better job keeping up with their monthly payments.

To assist the Military Services in delivering financial messages, the Department established the Financial Readiness Campaign in May 2003, which has gathered the support of 26 nonprofit organizations and Federal agencies. In the past three years, Service members have benefited from the materials and assistance from over 20 active partnerships. These partnerships are on-going and have been developed to allow the Military Services to choose which partner programs can best supplement the education, awareness, and counseling services they provide. The materials and services supplement but do not take the place of the programs offered by the Military Services.

Aspects of predatory lending practices are covered as topics in initial financial education training and in refresher courses offered at the military installations and aboard ships. The Military Services annually provide over 10,000 classes and train approximately 24 percent of the force, as well as nearly 20,000 family members. These classes are primarily conducted on military installations located in the United States.

In addition to these classes, Financial Readiness Campaign partner organizations conduct over a thousand classes informing over 60,000 Service members and family members per year. These classes are primarily provided by the staff of banks and credit unions located on military installations (military banks and defense credit unions). These institutions provide these classes as part of their responsibilities outlined in the DoD Financial Management Regulation. Other organizations involved include local Credit Counseling Agencies, State financial regulatory agencies, the InCharge Institute, and the NASD Foundation.

The Military Service financial educators, along with partner organizations, also distributed over 200,000 brochures and pamphlets, with the Military Services and the Federal Trade Commission primarily providing these products. In addition, *Military Money Magazine* has run several articles, to include two cover articles on predatory lending. The magazine is free and is distributed through military commissaries, family support centers and other service agencies on the installation, as well as to residents on installation and to addresses off the installation upon request. The distribution is approximately 250,000 per quarter.

*Lending Practices Considered Predatory*

As identified in GAO Report 05–349, *DOD's Tools for Curbing the Use and Effects of Predatory Lending Not Fully Utilized,* April 2005, the review of practices that are considered predatory has not benefited from a consistent definition that has been universally applied. However, sources studying the issue of predatory lending have focused on similar characteristics. GAO Report 04–280, *Federal and State Agencies Face Challenges in Combating Predatory Lending,* January 2004, said the following:

> While there is no uniformly accepted definition of predatory lending, a number of practices are widely acknowledged to be predatory. These include, among other things, charging excessive fees and interest rates, lending without regard to borrowers' ability to repay, refinancing borrowers' loans repeatedly over a short period of time without any economic gain for the borrower, and committing outright fraud or deception.

This definition has been reiterated in the FDIC Office of the Inspector General Audit Report 06–0111, June 2006, which stated:

> Characteristics associated with predatory lending include, but are not limited to, (1) Abusive collection actions, (2) balloon payments with unrealistic repayment terms, (3) equity-stripping associated with repeat financing and excessive fees, and (4) excessive interest rates that may involve steering a borrower to a higher-cost loan.

These same characteristics were also identified in the DoD Report to Congress on *Predatory Lending Practices Directed at Members of the Armed Forces and Their Dependents,* August 9, 2006:

> Predatory lending in the small loan market is generally considered to include one or more of the following characteristics: High interest rates and fees; little or no responsible underwriting; loan flipping or repeat renewals that ensure profit without significantly paying down principal; loan packing with high cost ancillary products whose cost is not included in computing interest rates; a loan structure or terms that transform these loans into the equivalent of highly secured transactions; fraud or deception; waiver of meaningful legal redress; or operation outside of state usury or small loan protection laws or regulations. The effect of the practices include whether the loan terms or practices listed above strip earnings or savings from the borrower; place the borrower's key assets at undue risk; do not help the borrower resolve their financial shortfall; trap the borrower in a cycle of debt; and leave the borrower in worse financial shape than when they initially contacted the lender.

While the Report to Congress provides a more expansive definition, there are several commonalities among the definitions listed above:

- Lending without regard of the borrowers ability to repay;
- Excessive fees and excessive interest rates;
- Balloon payments with unrealistic repayment terms;
- Wealth stripping associated with repeat rollovers/financing; and
- Fraud and deception.

The Department started collecting information on high cost lending in 2004 as part of the Defense Manpower and Data Center annual surveys of active duty Service members. The survey requested input on payday loans, rent-to-own, refund anticipation loans and vehicle title loans. GAO Report 05–359 focused on these four practices and obtained feedback from command leaders, Personal Financial Management (PFM) program managers, command financial counselors, legal assistance attorneys, senior noncommissioned officers (pay grades E8 to E9), chaplains, and staff from the military relief/aid societies. Data from these and others indicate that providers of such loans may be targeting Service members.

The Report to Congress reviewed five products (payday loans, vehicle-title loans, rent-to-own, refund anticipation loans, and military installment loans) identified by installation-level financial counselors (employed as PFM program managers and employed by the Military Aid Societies) and legal assistance attorneys who regularly counsel service members on indebtedness issues. When compared against the common characteristics listed above, the five products reviewed in the Report to Congress measure up somewhat differently:

| Lending product | Without regard for borrowers' ability to repay | Excessive fees and interest | Unrealistic payment schedule | Repeated rollover/refinancing |
|---|---|---|---|---|
| Payday loan | X | X | X | X |
| Vehicle title loan | X | X | X | X |

| Lending product | Without regard for borrowers' ability to repay | Excessive fees and interest | Unrealistic payment schedule | Repeated rollover/refinancing |
|---|---|---|---|---|
| Military installment loan | | X | | |
| Refund anticipation loan | | X | | |
| Rent-to-own | X | X | | |

A major concern of the Department has been the debt trap some forms of credit can present for Service members and their families. The combination of little-to-no regard for the borrower's ability to repay the loan, unrealistic payment schedule, high fees, and interest and the opportunity to roll over the loan instead of repaying it, can create a cycle of debt for financially overburdened Service members and their families.

Consumer groups, news media, and academics have chronicled concerns about payday loans and the propensity for this lending practice to create a cycle of debt. For example, M. Flannery and K. Smolyk state the following in their June 2005 FDIC Financial Research Working Paper No. 2005–09:

> Although as economists we find it hard to define what level of use is excessive, there seems little doubt that the payday advance as presently structured is unlikely to help people regain control of their finances if they start with serious problems.

Likewise, vehicle title loans are similarly structured, with potentially similar results. According to a November 2005 report by the Consumer Federation of America, vehicle title loans are generally made for 30 days with high interest/fee structures (average of 295 Annual Percentage Rate (APR)). Limits on title loans vary by State concerning interest rates, duration, rollover allowances, and rules on repossessing the vehicle. Only four states cap interest rates at less than 100% APR. In many states these loans can be rolled over by the borrower several times if the borrower is unable to pay the principal and interest when due. If not paid or rolled over, many states allow the creditor to repossess the vehicle and in some states the borrower is not entitled to any portion of the proceeds of the vehicle sale. Loan amounts average 55 percent of the value of the vehicle.

Rent-to-own, refund anticipation loans, and some military installment loans present products with high fees and interest. Rent-to-own, which is not covered as credit under the Truth-in-Lending Act (TILA), can represent an expensive alternative to credit when used as a means of purchasing an item. Military installment loans (an installment loan marketed primarily or exclusively to the military) can represent a high cost over the duration of the loan, particularly when other charges are added to the interest rate. Tax refund anticipation loans (RALs) also cost Service members and their families high fees when they can easily obtain rapid returns through electronic filing with the assistance of their installation legal assistance office.

According to the Consumer Federation of America (report dated February 5, 2007) the advantage of RALs is minimal when comparing the speed of the refund (between 7 and 14 days faster) against the cost of the service ($30—$125). Moreover, the APR for this credit can be triple digit. A study by Gregory Elliehausen of the Credit Research Center (CRC) (Monograph #37, April 2005) showed a disproportionate percentage of individuals under 35 years old use RALs. Sixty-one percent of RAL borrowers were below 35 years old, although individuals below 35 years old represent 28.6 percent of heads of households. This is significant since 79 percent of Service members are 35 years old or below.

The reason for using RALs vary. The CRC study showed that 41 percent of borrowers obtain RALs to pay bills, 21 percent due to unexpected expenditures, 15 percent to make purchases, 15 percent because of impatience, and 7 percent for other reasons. Less than one percent said they obtained a RAL to pay for tax preparation. Through the Armed Forces Tax Council, in collaboration with the IRS, Volunteer Income Tax Assistance sites are located on most active duty military installations to assist Service members and their families with preparation and electronic filing of their tax returns.

As with other forms of short-term, high cost credit, the Department would prefer Service members and their families to consider low cost alternatives to resolve their financial crisis by establishing a more solid footing for their personal finances. The CRC study found that users of RALs and payday loans both had similar levels of debt and patterns of credit use. Additionally, through education the Department attempts to persuade Service members that planning is an important part of managing finances, and a high cost 10-day loan does not reinforce this lesson.

The five products reviewed in the Report to Congress represent two kinds of financial problems for Service members and their families: Those products that contribute to a cycle-of-debt (payday and vehicle title loans) and those products that can cost the military consumer high fees and interest costs (rent-to-own, installment loans and refund anticipation loans). Cycle of debt represents a more significant concern to the Department than the high cost of credit.

The Department considered the five products in developing the regulation. Trade associations and financial institutions expressed their concern that the regulation needed to be very clear about when the provisions of the statute applied. During our consultation with the Federal regulatory agencies, they reiterated the need for "clear lines" around definitions of covered consumer credit and the impacted creditors.

The regulation has focused on credit products that have, in general practice, terms that can be detrimental to military borrowers. Rent-to-own services provide rental opportunities (not covered by the Department's rule making), as well as options for ownership which are not loans under TILA. As a consequence, rent-to-own products and services were not covered. Likewise, there are installment loans with favorable terms and some with terms that can increase the interest rate well beyond the limits prescribed by 10 U.S.C. 987. Isolating detrimental credit products without impeding the availability of favorable installment loans was of central concern in developing the regulation. Consequently, installment loans that do not fit the definition of "consumer credit" in Section 232.3(b), including the definition of "payday loans," "vehicle loans," or "tax refund anticipation loans" are not covered by the regulation. The Department's intent is to balance protections with access to credit. The protections posed in the statute assist Service members, when applied with precision to preclude unintended barriers.

*Alternatives*

The Department prefers that Service members and their families who experience financial duress seek help through Military Aid Societies, military banks and defense credit unions rather than credit products that would more likely mire them in a cycle of debt. These institutions have established programs and products designed to help Service members and their families resolve their financial crises, rebuild their credit ratings and establish savings.

The Military Aid Societies are strong advocates for limiting the cost associated with credit and for creditors to develop alternative products for Service members who cannot otherwise qualify for loans. Within their own resources they provided $87.3 million in no-cost loans and grants to Service members and their families in 2005. These funds were provided for emergencies and essentials, such as rent, food, and utilities.

Financial institutions located on military installations also understand the need to provide products and services that can help those who mishandle their finances and who may need remedial assistance. A review of on-base financial institutions surfaced 24 programs on 51 military installations in the U.S. providing alternative small loan products designed to help Service members and their families to recover from their financial problems. These financial institutions supplement the emergency funding made available by the nonprofit Military Aid Societies that provide grants and no-interest loans to needy Service members and families.

These financial institutions provide low denomination loans at reasonable APRs designed to assist their members who need to get out of high cost credit and into more traditional lending products. Financial counseling and education are often prerequisites for the short term loans and some institutions have attached a requirement to develop savings as part of the loan.

Many of these military banks and credit unions use their products and services to maintain a watchful eye over their members to ensure they do not abuse services designed to assist them, such as overdraft protection, which if used on a chronic basis, can become very expensive and propel someone already overextended into a deeper spiral of debt. Representatives of the Association of Military Banks of America had an opportunity to showcase their alternative small loan products at a FDIC Conference in December of 2006. FDIC hosted this conference to spotlight the need to develop more of these types of products for Service members and their families and several financial institutions described above that currently provide such favorable credit to Service members participated in the conference.

Subsequent to the conference, FDIC issued guidelines to FDIC-supervised banks to encourage them to offer affordable small-dollar loan products. These guidelines explore a number of aspects of developing alternative small loan products, including affordability and streamlined underwriting. They also discuss tools such as financial education and savings that may address long-term financial issues that concern borrowers.

At the same time, the FDIC approved a two-year pilot project to review affordable and responsible small-dollar loan programs in financial institutions. The project is designed to assist institutions by identifying information on replicable business models for affordable small-dollar loans. FDIC expects to identify best practices resulting from the pilot that will become a resource for institutions. The Department supports the FDIC's efforts with the guidelines and the pilot project as they both will help encourage banks to meet the demand for small-dollar loans at more reasonable costs for the borrower.

*Efforts To Curb the Prevalence and Impact of Predatory Loans*

The Department has found that it has a small window of opportunity to convince and inform Service families about products and services beneficial to their particular situations, a job complicated by many contrary messages and enticements. Nonetheless, the Department has attempted to use the processes and resources available within the Department to curb the prevalence of high cost short term lenders, particularly those that can contribute to a spiral of debt.

Predatory lenders have seldom been placed off-limits, primarily because the process associated with placing commercial entities off-limits, through the review and recommendations of the Armed Forces Disciplinary Control Board (AFDCB), is not well suited to this purpose. The AFDCB, covered by Joint Army Regulation 190–24, is designed to make businesses outside of military installations aware that their practices raise morale and discipline concerns and to offer these businesses an opportunity to modify their practices to preclude being placed off-limits. When the commercial entity refuses to comply, the AFDCB recommends that the regional command authority place the business off-limits for all Service members within the region (regardless of Service).

Normally concerns are raised when a business has violated State or Federal laws. Remediation involves the business curtailing these illegal practices. In the case of the loan products listed above, businesses usually offer their services within the legal limits. Since the AFDCB takes on businesses one at a time, bringing a lender under scrutiny has been difficult if the lender is complying with the same rules as its competitors. Additionally, the magnitude of mediating with the number of outlets surrounding military installations has exacerbated the process. Numerous payday lenders can be found in communities around military installations (Graves and Peterson, Ohio State Law Journal, Volume 66, Number 4, 2005).

Also without clear standards and prohibitions, commanders and AFDCBs cannot easily identify what remediation lenders offering payday, auto title, and refund anticipation loans should take. In states without relevant laws, Commanders and AFDCBs must not only establish rules, but they must also educate those affected and then monitor their compliance.

As stated above, the Department will continue to provide education, awareness, and counseling programs to influence skills and attitudes towards managing personal resources wisely. There still remains a gap between the opportunity to influence a young Service member or family member concerning the best way to manage their finances, and the level of experience and capability necessary to be successful. The Department has a limited opportunity to impress upon these young people the importance of managing their resources. It does not have sufficient control over the behavior of Service members and their families to preclude them from taking on financial risks that can detract from not only their quality of life, but also military mission accomplishment.

The Department will continue to send Service members messages that they and their families need to manage their resources wisely for their own benefit and to maintain personal readiness. The Department's call for responsibility competes with market messages from the sub-prime financial industry to get cash now for purchases, vacations, and paying bills. Their marketing stresses the ease and convenience of obtaining these loans, with a virtual guarantee of approval. These messages can be particularly alluring to Service members

and families already overburdened with bills and debts. A 2006 survey accomplished by the Consumer Credit Research Foundation concluded that Service members choose payday loans primarily because they are convenient. Certainly, obtaining "fast cash" from a payday lender is far easier than coming to terms with delinquent debt or addressing inherent overspending that creates situations where sub-prime loans are needed.

Service members have inherently understood that limits on interest rates are appropriate, even if these limits would decrease the availability of credit. When asked in a 2006 survey conducted by the Consumer Credit Research Foundation if Service members strongly agree, somewhat agree or disagree with the statement: "The government should limit the interest rates that lenders can charge even if it means fewer people will be able to get credit," over 74 percent of the Service members surveyed agreed with the statement (over 40 percent strongly agreed). Similarly when asked their position on the statement "There is too much credit available today," 75 percent of Service members not using payday loans and 63 percent of Service members using payday loans agreed (51 percent of non-users strongly agreed).

*"Limitations on Terms of Consumer Credit Extended to Service Members and Dependents," John Warner National Defense Authorization Act for Fiscal Year 2007, Section 670, Codified at 10 U.S.C. 987*

10 U.S.C. 987 directs the Secretary of Defense to establish and implement regulations concerning consumer credit services for Service members. Implementing regulations must be completed and published prior to October 1, 2007, after consultation with the Department of Treasury, Office of the Comptroller of the Currency, Office of Thrift Supervision, Board of Governors of the Federal Reserve System, Federal Trade Commission, Federal Deposit Insurance Corporation, and the National Credit Union Administration. Specifically, section 987(h)(2) requires the Secretary of Defense to issue regulations establishing 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.

This broad latitude allows the Department to determine the scope and impact of the regulation, consistent with the provisions of the statute. These provisions have been established to protect Service members and their families from potentially abusive lending practices and products. The statute provides several limitations on credit transactions, and allows the Department to focus these limitations on areas of greatest concern.

As noted in the preamble to the proposed rule, the Department has learned of the potential for unintended consequences that could adversely affect credit availability if it were to adopt a broadly applicable regulation. Some comments received suggested that one way to limit the potential adverse and unintended consequences of the statute would be to adopt a regulation that provided for a general or conditional exception for credit products offered by insured depository institutions and their subsidiaries. While the proposed rule did not include any exceptions for insured depositories or their subsidiaries, the Department explicitly asked for comment on the issue.

Most respondents to the request for comments addressed the question of whether the final rule should exclude insured depository institutions from coverage generally or in limited circumstances. Almost all representatives of insured depository institutions strongly supported the Department exempting lenders that are subject to supervision by a Federal banking agency. They noted that these institutions have not been identified as engaging in predatory lending practices. Consumer representatives, on the other hand, as well as the FTC staff who provided comment on this issue, did not favor making distinctions in the "creditor" definition based on whether or not the lender was subject to supervision by Federal banking agencies.

Comments from lending institutions about the need for a general or limited exemption of Federally-insured depository institutions and their subsidiaries from this regulation were tempered in part by their support of the proposed definition of "consumer credit," which is limited to potentially abusive credit products identified by the Department in its report to Congress. Specifically, they noted that if the regulations were expanded to cover a wider range of financial products, the need for an exemption of insured depository institutions from this regulation would be increased to ensure that Service members and their dependents have access to affordable credit by responsible lenders.

The intent of the statute is clearly to restrict or limit credit practices that have a negative impact on Service members without impeding the availability of credit that is benign or beneficial to Service members and their families. The Department has determined that given the limited types of credit products covered by the rule, an exemption for depository institutions is not needed to ensure access to beneficial credit by Service members and their dependents. Accordingly, the final rule does not provide exemptions for insured depository institutions or their subsidiaries. As noted above, Federally-supervised financial institutions that commented appeared to be concerned about future iterations of the regulation and the potential for the regulation to impact their ability to provide beneficial credit to Service members and their families. If the Department considers it necessary to reconsider the products included as covered consumer credit, the issue of such exemptions would also be reconsidered.

## II. Description of the Regulation, by Section

*232.1 and 232.2, Authority, purpose and coverage, and Applicability:* No comments were received on these provisions. The provisions in the proposed rule are being adopted without substantive change.

*232.3, Definitions:* In implementing the statute, the Department has defined the terms "creditor" and "consumer credit" judiciously, having heard from numerous groups through comments received in response to **Federal Register** notice DoD–2006–OS–0216, solicited and unsolicited comments, and through meetings requested of the Department that applying the provision broadly would create numerous unintended consequences. These unintended consequences would have a "chilling effect" on the availability of consumer credit for Service members and their dependents in circumstances that are not necessarily predatory.

In defining the term "creditor," the statute provides the following:

(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.

Consistent with the statute, the final rule defines "creditor" as any person who extends consumer credit covered by part 232. For this purpose a "person" includes both natural persons as well as business entities, but would exclude governmental entities. Pursuant to the Department's authority to specify additional criteria, a person would be a creditor only if the person is also a "creditor" for purposes of the Truth in Lending Act (TILA). Section 987(c) of 10 U.S.C. provides that the disclosures required by that section be presented along with the disclosures required under TILA, and in accordance with the terms prescribed by the regulations implementing TILA. Thus, it does not appear that section 987 was intended to apply to persons or transactions that are not covered by TILA.

For clarity, the Department has implemented the provision covering assignees by including a specific reference to assignees in each section of the regulation that would apply to an assignee, in lieu of including assignees in the definition of "creditor." See sections 232.4, 232.8 and 232.9.

The definition of consumer credit provided in the statute is as follows:

(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.

It is clearly the intent of the statute that the Department define which types of consumer credit transactions shall be covered by the law, provided that they do not include the two listed exemptions. This is because the statute authorizes the Department to specify additional criteria for an entity to be considered a creditor that is engaged in the business of extending consumer credit. The Department has exercised this authority by limiting the rule's applicability to creditors that engage in certain types of consumer credit transactions. Accordingly, the final rule focuses on three problematic credit products that the Department identified in its August 2006 *Report to Congress on the Impact of Predatory Lending Practices on Members of the Armed Forces and Their Dependents:* payday loans, vehicle title loans, and refund anticipation loans. The Department's definition of the term "consumer credit" in the proposed rule was intended to narrow the regulation's impact to consumer credit products and services that are potentially detrimental and for which there are DoD-recommended, alternative products or services available to Service members and their dependents. DoD believes that a narrow definition will prevent unintended consequences while affording the protections granted by the statute.

After review of comments received through the **Federal Register** publication of the proposed rule, the Department believes that the scope of the regulation as proposed is appropriate to address the concerns that formed the basis of its report to the Congress. Comments received from consumer advocates and some others expressed the view that the Department's proposed definition of "consumer credit" was too narrow and that creditors could restructure their loan products to make high-cost extensions of credit while avoiding coverage under Part 232. Comments received from representatives of federally-insured depository institutions generally supported the consumer credit definition in the proposed rule.

The Department continues to believe that the scope of the proposed rule and the definition of consumer credit are appropriate. The Department maintains the ability to issue additional rules in the future and the Department plans to continue surveying Service members and their dependents to collect data on their use of credit products. The Department will also monitor market developments that affect Service members and will obtain a variety of inputs from regulatory agencies, consumer protection groups and the credit industry to assess the level of protection provided by the final rule. The Department will review this data to determine if further revisions are needed. Accordingly, the proposed definition of "consumer credit" is being adopted without substantive change. The Department has made technical changes to the regulation to clarify that the consumer credit defined in the regulation is closed-end credit and not open-end credit.

With respect to exclusion of "residential mortgages" the final rule adopts the proposed rule's exclusion which applies to any credit transaction secured by an interest in the borrower's dwelling. Thus, home-purchase transactions, refinancings, home-equity loans, and reverse mortgages would be excluded. Home equity lines of credit are also excluded. In addition, the property need not be the consumer's primary dwelling to qualify for the exclusion. A "dwelling" includes any residential structure containing one to four units, whether or not the structure is attached to real property, and would also include an individual condominium unit, cooperative unit, mobile home, or manufactured home.

Payday Loans

Payday loans have common characteristics that make them detrimental to a Service member's financial well being and inferior to alternative sources of emergency support. These characteristics can exacerbate a cycle of debt, particularly if the borrower is already over-extended through the use of other forms of credit. The final rule defines "payday loans" based on certain characteristics, in order to distinguish them from other financial products. A payday loan is defined as *a closed-end credit transaction having a term of 91 days or fewer, where the amount financed does not exceed $2,000.* The "amount financed" is not defined in this regulation, but must be determined based on the definition of that term in the Federal Reserve Board's Regulation Z, which implements the TILA. In addition, the definition of "payday loan" is limited to transactions where the borrower contemporaneously provides a check or other payment instrument that the creditor agrees to hold, or where the borrower contemporaneously authorizes the creditor to initiate a debit or debits to the covered borrower's deposit account.

Payday loans, otherwise known as deferred presentment loans, are allowed in 39 States as a separate credit product from other forms of credit regulated by Federal or State statute. States authorizing these types of loans require payday lenders to obtain a license to operate within the State. States have defined these products and services, primarily through the basic process used to secure a payday loan, either through holding a check or by obtaining access to a bank account through electronic means. These basic processes have been included as part of the definition of payday loans in the regulation (Section 232.3(c)). Many States have also established limits to the amount that can be borrowed and the duration of the loan as part of the authorized activities of lenders licensed to offer these products and services. A review of State limits for payday loans

establishes a foundation for the definition used in this regulation.

The majority of States have a maximum dollar amount, maximum time limits and maximum fees that trigger regulation. Six States (New Mexico, Oregon, Texas, Utah, Wisconsin and Wyoming) have no dollar limit on the amount that can be loaned, and nine States (Alaska, Arizona, Idaho, New Mexico, Rhode Island, South Dakota, Virginia, Wisconsin and Wyoming) have no maximum limit established for the duration of a payday loan. Of the States that impose limits on the loan amount or loan duration, the highest dollar limit is $1,000 (Idaho and Illinois) and the longest permissible loan term is 180 days (Ohio). The average dollar limit is $519 and the average limit on loan term is 46 days.

Payday loans offered over the internet often originate in States with no limits on fees or maximum loan amounts. A survey of websites offering payday loans indicates $1,500 as generally the maximum amount loaned. A review of sites marketing "Military Payday Loans" refer to loans of up to 40 percent of a Service member's take home pay. This amount can vary considerably based on rank, other entitlements, tax withheld and military allotments. For married enlisted Service members in the grade of E–6 and below (no deductions for taxes or other allotments), the $2,000 limit in the final rule would cover a loan made for 40 percent of take-home pay. The limits established in the definition for payday loans reflect the maximum duration and amount anticipated for loans based on current State practices, to include internet payday loans originating from locations without limits.

Many respondents expressed some concern that the four-part definition of payday loans may allow creditors to change one aspect of their product to evade the regulation, such as extending the length of the loan or extending open-end credit. The Department's intent is to balance these concerns against the concerns expressed by other respondents that the definition should remain as narrow as proposed to preclude unintended consequences regarding short-term, small-dollar credit availability for covered borrowers. Most financial institutions requested that the definitions of consumer credit clearly specify that they apply to closed-end loans to preclude misinterpretations.

Industry and consumer group respondents requested clarification of the payday loan definition. Specifically, they sought to clarify that borrowers must provide a check to the creditor or authorize a debit to the borrower's deposit account contemporaneously with the borrower's receipt of funds, and not contemporaneously with the payment of interest or fees. Section 232.3(b)(1)(i) of the final rule has been modified to make this clarification.

The definition of "payday loans" includes transactions where the covered borrower receives funds and contemporaneously authorizes the creditor to initiate a debit or debits to the borrower's deposit account. However, there is an exclusion to this definition in 232.3(b)(1)(i)(A): "*This provision does not apply to any right of a depository institution under statute or common law to offset indebtedness against funds on deposit in the event of the covered borrower's delinquency or default.*" This exclusion only applies to a depository institution's right of offset under State or other applicable law.

Vehicle Title Loans

The Department believes that vehicle title loans should be included within the definition of consumer credit, and that covering such transactions is consistent with the law's purpose. The definition for "vehicle title loans" limits the rule's coverage to loans of 181 days or fewer. Many States have not established statutes overseeing these loans. A 2005 survey of States conducted by the Consumer Federation of America found that, of the 16 States authorizing vehicle-title lending, 10 require 30-day or one-month term limits (with authorized renewals or extensions), and one State allows up to 60 days (with 6 renewals). Four States do not establish term limits.

Some consumer groups remarked that the scope of the definition for vehicle title loans may not encompass all practices used by creditors to provide high-cost, short-term vehicle title loans. Some industry respondents said the restrictions in the regulation may make some creditors reluctant to offer beneficial loans to covered borrowers with poor or no credit history. However, the majority of federally-insured depository institution respondents said that their loans that use vehicles as collateral would be unaffected since they are made for longer than 181 days.

As with payday loans, the Department has sought to balance the definition of vehicle title loans to reflect the countervailing concerns of respondents. The Department does not want protections from high-cost, short-term vehicle title loans to unnecessarily inhibit covered borrowers from accessing beneficial loans for which a vehicle is used as collateral.

Comments received from a group of bank trade associations asked that the rule clarify that "motor vehicle" only includes vehicles which must be registered pursuant to state law. The final rule has been modified to make this clarification.

Refund Anticipation Loans

The Department believes that covering RALs is consistent with the intent of the statute. They have been included because survey data has shown RALs to be the second most prevalent high cost loan used by Service members, and because alternatives that can expedite their tax returns are available, generally at no cost. Some states have also addressed concerns with RALs. Connecticut has established a rate cap for RALs, prohibiting transactions where the APR exceeds 60 percent. Other states, such as California, Washington, Oregon, and Nevada, have established statutes specifying disclosure requirements for RALs. Respondents representing tax preparers and financial institutions providing RALs objected to being included in the definitions of covered consumer credit products, stating their product does not contribute to a cycle of debt or place a critical family asset at risk.

Credit union trade association respondents and bank trade association respondents said the inclusion of RALs in the rule would have little impact on their members because so few of them make these loans, and the few that do make them will likely cease doing so because of the rule's requirements. The Department believes that its definition of RALs limits unintended consequences and allows for refunds to be provided expeditiously.

One commenter expressed concern that the rule could be construed to apply when a borrower notes that the source of repayment is the tax refund. The intent of the regulation is to cover credit products that are designed expressly to use tax refunds as the collateral for the loan. The rule does not cover loans where borrowers merely note that a tax refund may be used to repay the advance. To ensure the Department's intent is clear, the word "expressly" has been repeated in the RAL definition to modify the statement concerning repayment of the loan.

Loans Where the MAPR Is Less Than 24%

In its proposal the Department solicited comments on other approaches that would encourage lenders to offer responsible, small-dollar, short-term loans that meet the credit needs of Service members and their dependents. For example, comment was solicited on whether loans should be exempt from

coverage under Part 232 if the MAPR were less than 24%.

Industry respondents generally said that such an exemption would have little impact on credit products defined in the regulation because the credit product definitions are already narrow enough in scope to leave institutions room to provide affordable small-dollar loans to Service members and their dependents. Some consumer groups favored such an exemption only if it were part of a "safe harbor" accompanied by significantly broader definitions of covered credit products. The Department has not adopted an MAPR-based exemption from the definition of consumer credit in the final rule to include this recommendation. To accommodate current and potential small-dollar, short-term loan programs, the Department has already made allowances in the regulation for credit products that are within the MAPR limit of section 232.4(b) and believes these are sufficient to support lower cost alternatives.

Definition of MAPR

The definition of MAPR creates a distinctive percentage rate that reflects the provisions of the statute. The MAPR does not include fees imposed on the borrower for unanticipated late payments, default, delinquency or a similar occurrence, because such fees are imposed as a result of contingent events that may occur after the loan is consummated. Thus, such fees are not included in the computation of the maximum 36% MAPR cap imposed by these rules.

Many respondents expressed concern that disclosing both an MAPR and an APR to Service members and their dependents would cause confusion. The statute requires that the MAPR be presented to the covered borrower. The Department will take steps to educate Service members and their dependents on the MAPR.

While acknowledging that the narrow scope of the rule will ease the potential for confusion, comments from industry representatives sought to modify the MAPR definition to make it as close as possible to the APR disclosed under TILA. By contrast, consumer groups contended that the MAPR definition should include all cost elements, and should not contain exclusions in the proposed rule, such as for actual unanticipated late payments.

The Department has designed the definition of MAPR within the context of the consumer credit covered by the regulation. The Department's intent is to ensure that the credit products covered by the regulation cannot evade the 36 percent limit by including low interest rates with high fees associated with origination, membership, administration, or other cost that may not be captured in the TILA definition of APR.

Some industry respondents were concerned about including costs in the MAPR that are "associated with the extension of consumer credit" because this may include costs for products or services that are purchased in connection with a loan, but are not required. For example, industry respondents argue that ancillary products (such as voluntary credit insurance and debt cancellation coverage) should not be included in the MAPR calculation because these products may protect borrowers against being burdened with debt if a covered event occurs.

The Department believes the definition is consistent with the statute and is appropriate in the context of the consumer credit covered by the rule. The Department is concerned that Service members are sold products such as voluntary insurance without having these credit insurance products placed in the context of the Service member's employment status or his or her current level of insurance coverage. Additionally, the Department is concerned about small loans that are associated with sales of products or services not related to the loans, such as credit offered as part of Internet access or catalog sales. The definition has been designed to cover sales such as these or sales similar to those mentioned in this paragraph and considers them "associated with the extension of consumer credit."

One commenter expressed concern that only fees for "actual unanticipated" late payments would be excluded from the MAPR, because some borrowers might notify the lender if they know their payment will be late. The language in the proposed rule tracks the language in section 226.4(c)(2) of Regulation Z, which excludes such fees from the APR disclosed under TILA. The intent is to exclude charges from the MAPR that the lender does not anticipate under the terms of the agreement. The language in the final rule is being adopted as proposed, so that creditors determinations under Part 232 will be consistent with their existing practice under TILA.

The final rule also has been revised to clarify that the MAPR does not include certain taxes or fees prescribed by law, such as fees paid to public officials in connection with perfecting a security interest. See § 232.3(h)(2)(i) and (ii). The revision is being made for consistency with the Federal Reserve Board's Regulation Z, which does not require such charges to be included in the APR disclosed under TILA.

Industry respondents also requested that the final rule clarify that the definition of "consumer credit" be limited to closed-end transactions so that the rules are not unintentionally interpreted to include credit cards. Many respondents stated it was not clear whether the rule included open-end credit and that it is important that the final rule explicitly state it is limited to the three listed closed-end credit products. In order to clarify that the regulation covers only closed-end credit, the definition in 232.3(b) has been modified to include the words "closed-end" as part of the definition of covered consumer credit.

*232.4, Terms of consumer credit extended to covered borrowers:* This section implements the statutory prohibition limiting the amount that creditors may charge for extensions of consumer credit to covered borrowers. The proposed rule mirrors the statutory language. This section also applies to "assignees" consistent with the statutory definition of "creditor."

*232.5, Identification of covered borrower:* The Department has received several comments expressing concern over the potential difficulty in identifying a covered borrower, particularly in light of the penalties for failing to provide the statutory protections to a covered borrower. While the Department recognizes this concern, the Department would emphasize that identifying the covered borrower is only relevant in the context of transactions defined by the regulation as consumer credit (for payday loans, vehicle title loans and refund anticipation loans).

Some respondents expressed concern that imposing a duty on creditors to identify dependents of active duty Service members in order to comply with Part 232 would conflict with the Equal Credit Opportunity Act, which is implemented by the Federal Reserve Board's Regulation B. These respondents noted that under Regulation B, a creditor may not inquire about a credit applicant's marital status. The Department notes, however, that the final rule does not require creditors to inquire about marital status. The "covered borrower identification statement" contained in § 232.5(a) of the final rule requests credit applicants to identify if they are a dependent based on any of the listed criteria (spouse, child or individual for whom the member provides financial support), but

does not require an applicant to specify which one of these applies in their specific case. Accordingly, the "covered borrower identification statement" does not inquire about an applicant's marital status. The Department also notes that § 202.5(a)(2) of the Federal Reserve's Regulation B states that creditors may obtain information required by federal statutes or regulations. The Department has consulted with staff of the Federal Reserve Board, and they agreed with the Department's analysis.

The Department's intent is to balance protections for covered borrowers (according to the statute) while also addressing creditors' need to have some degree of certainty in determining that the loans they make are in compliance with the statute as implemented by Part 232. The Department understands creditors may otherwise decline offering beneficial credit products to covered borrowers as a result of concerns over potential violations. To achieve an appropriate balance, the Department has proposed a safe harbor, under which the creditor may require the applicant to sign a statement declaring whether or not he or she is a covered borrower (using the definition from the statute). If required by the creditor, this declaration provides a "safe harbor" for the creditor to prevent inadvertently violating the statute by failing to recognize a covered borrower. For creditors who provide consumer credit, as defined by the regulation, by means of the Internet, the applicant can provide an electronic signature that fulfills the requirements of the Electronic Signatures in Global and National Commerce Act, 15 U.S.C. § 7001 et seq.

There is one caveat to this "safe harbor" provision. If the loan applicant signs a declaration that denies being a covered borrower, but the creditor obtains documentation as part of the credit transaction reflecting that the applicant is a covered borrower (such as, a current military leave and earning statement as proof of employment), the applicant's declaration would not create a safe harbor for the creditor. In such cases, creditors should seek to resolve the inconsistency, but if they are unable to do so, they may avoid any risk of noncompliance by treating the applicant as a covered borrower based on the documentation or by declining to extend credit due to the inability to verify information provided in the borrower's signed declaration.

This caveat prevents creditors from using the declaration to allow covered borrowers to waive their right to the protections provided by the regulation. This may occur when the creditor recognizes the applicant is a covered borrower as a result of the documents presented as part of the credit transaction. The intent of this caveat is not to hold the creditor accountable for false statements made by an applicant when there is no indication through the credit transaction that the applicant is a covered borrower.

In contrast, when an applicant claims to be a covered borrower without presenting proof of status, further validation by the creditor is not required. However, creditors have the option of verifying the applicant's status as a covered borrower using several sources of information, but they are not required to do so. Thus, creditors may request applicants to provide proof of their current employment and income, for example by requesting from service members a copy of the most recent month's military leave and earning statement. Creditors may also request Service members or dependents to provide a copy of their military identification card.

These sources, however, might not always be determinative. For example, in some cases a leave and earnings statement might not reflect a recent change in the applicant's active duty status. Military identification cards, which are the same as identification cards carried by members of the active component, are issued to members of the National Guard and the Reserve regardless of their duty status. Hence, the final rule states "*[u]pon such request, activated members of the National Guard or Reserves shall also provide a copy of the military orders calling the covered member to military service and any orders further extending military service.*" This would also be the case for their dependents. The final rule does not provide a safe harbor to creditors in the situation described in this paragraph.

It is the Department's understanding that providing proof of employment is a prerequisite to receiving a payday loan or a vehicle title loan. The military leave and earning statement is the document that provides validation of employment.

The Department will provide access to a database to creditors to validate the status of an applicant. This arrangement is currently available to creditors to validate the active duty status of Service members as part of implementation of benefits authorized by the Servicemembers Civil Relief Act (*https://www.dmdc.osd.mil/scra/owa/home*). The proposed database (available at *http://www.dmdc.osd.mil/mla/owa/home*), will include the status of covered borrowers and can be used to resolve questions creditors may have about the status of an applicant who denies being a covered member and yet presents information during the credit transaction that is contrary to this declaration. In these situations, the database would provide the most accurate verification of the status of the applicant, to include activated members of the National Guard and Reserve and their dependents.

*232.6, Mandatory disclosures:* Section 232.6 describes the disclosures that must be provided to covered borrowers before they become obligated on a consumer credit transaction. This includes the new disclosures established under 10 U.S.C. 987 and also includes disclosures that creditors are already required to provide pursuant to the Federal Reserve Board's Regulation Z, which implements the TILA. Regulation Z contains certain requirements pertaining to the format of the TILA disclosures for closed-end credit transactions, including a requirement that they "shall be grouped together, shall be segregated from everything else, and shall not contain any information not directly related" to the disclosures required under Regulation Z. The Department intends that the disclosures required under this proposal be provided consistent with the format requirements of Regulation Z. Accordingly, the covered borrower identification statement described in § 232.5 and the disclosures provided pursuant to § 232.6(a)(1), (3), and (4) should not be interspersed with the TILA disclosures.

The general rule is that disclosures required by § 232.6(a) (1), (3), and (4) must be provided orally as well as in writing. However, in credit transactions entered into by mail or on the Internet, a creditor complies with this requirement if the creditor provides covered borrowers with a toll-free telephone number on or with the written disclosures and the creditor provides oral disclosures when the covered borrower contacts the creditor for this purpose. Consumer groups that commented stated that providing borrowers with a toll-free telephone number would not be sufficient because it places the burden on the borrower instead of the lender. Many industry respondents expressed concern about the costs of providing the disclosures, to include developing software, training employees about the new rules, and updating all their forms. The Department believes providing consumers with a toll-free telephone number to access oral disclosures fulfills the intent of the statute and balances overall considerations for protection with access to credit.

The Department has received several comments about potential disparities in disclosures required by this part as opposed to TILA. Many respondents felt that the current APR disclosures are barely understood by consumers and that adding a new MAPR disclosure to the mix will only serve to create more confusion. As with other aspects of the statute, the Department's intention has been to develop a regulation that is consistent with the statutory intent. The Department recognizes the potential confusion inherent in mandating the disclosure of two differing annual percentage rates (the MAPR required by this regulation and the APR required by TILA). As previously stated, the Department is responsible for training Service members and making similar education available for spouses. The differences between APR and MAPR will be added to their training, along with explaining their rights as a covered borrower. Some respondents sought clarification on whether MAPR disclosures would be required in advertising. These same respondents suggest that including MAPRs and APRs in marketing initiatives would be confusing to consumers. Under section 232.6 of the final rule, creditors must provide the required disclosures in writing before consummation of the transaction. Disclosure of the MAPR in advertisements is not required.

*232.7, Preemption:* The final rule implements the statute. Although, revisions have been made, this section has been drafted to clarify the statutory language, no substantive change is intended.

Some respondents expressed concern about the adequacy of enforcement for lenders that are not subject to enforcement by the federal depository institution supervisory agencies. The Department does not view the regulation as having substantial direct effects on States, or distribution of power and authority. States determine whether they will enforce the regulation or not for creditors under their jurisdiction. Associations of state supervisors recommended the Department seek written agreements between the Department and state regulatory agencies about enforcement, supervision, and information sharing to help state authorities enforce those areas that will normally fall under their jurisdiction. The Department intends to rely on federal and state regulators to oversee or enforce compliance with the final rule, to the extent possible under their statutory authority, for their respective creditors.

*232.8, Limitations:* Section 232.8(a) implements the statutory provision in 10 U.S.C. 987(e)(1), which prohibits a creditor from extending consumer credit to a covered borrower in order to roll over, renew, or refinance consumer credit that was previously extended by the same creditor to the same covered borrower.

The proposed regulation includes a limited exception to this prohibition, however, to permit workout loans and other refinancings that result in more favorable terms to the covered borrower, such as a lower MAPR. Most respondents agree that workout loans and other refinancings that are on "more favorable terms" for the borrower should be allowed. However, many respondents thought the standard for applying the exception was too subjective and would create uncertainty about what terms are considered "more beneficial." Respondents suggested that financial institutions might err on the side of caution and forego entering transactions that could benefit the borrower in order to avoid any potential liability. Some respondents proposed specific ways to give creditors more certainty, such as by permitting creditors to show how the refinancing benefits the borrower or by allowing any refinancing initiated by the covered borrower.

The final rule does not identify additional examples of "more favorable terms," because the Department has determined the definition currently included in the regulation is sufficient to allow creditors to provide workout loans on the basis of factors other than a lower MAPR that result in more favorable terms. By not limiting the phrase "more favorable terms" to a limited set of circumstances, covered borrowers will be protected without constraining creditors' ability to refinance loans on more favorable terms.

In the proposal, the Department solicited comment on whether it should adopt a rule clarifying that the refinancing or renewal of a covered loan requires new disclosures under § 232.6 only when the transaction would be considered a new transaction that requires TILA disclosures. Respondents' opinions differed, but most respondents stated that consistency between the Department's rules and Regulation Z would be less confusing and easier to implement. To maintain consistency between Part 232 and Regulation Z, the Department is adopting such a rule. See § 232.6(c). Whether or not new disclosures are required in a particular transaction, when a creditor refinances or renews an extension of consumer credit to a covered borrower, the limitations on rates and terms apply in the same manner as they would for the original transaction.

In some cases, a consumer might become a covered borrower after obtaining consumer credit. When consumers request to refinance or renew a short-term loan, creditors are likely to rely on their original determination that the consumer is not a covered borrower. Most respondents agreed that creditors should be able to rely on the original determination that the consumer is not a covered borrower for renewals and refinancings although a few argued for limiting the number of refinancings allowed before new disclosures and borrower identification were required. The Department believes that it would be unnecessarily burdensome to impose a duty on creditors to make a new determination in each transaction given that a change in the borrower's status will infrequently occur with short-term transactions. Accordingly, the final rule does not apply when the same creditor extends consumer credit to a covered borrower to refinance or renew an extension of credit that was not covered by Part 232 because the consumer was not a covered borrower at the time of the original transaction. See § 232.5(d).

Subparagraph (a)(3), in accordance with 10 U.S.C. 987(e)(3), makes it unlawful for any creditor to extend consumer credit to a covered borrower if the "creditor requires the covered borrower to submit to arbitration *or imposes other onerous legal notice provisions.*" Many respondents felt that a ban on "onerous" legal notice provisions was vague. Some offered examples of what should be considered onerous legal notice provisions, such as threats to use or using criminal process to collect a debt, making a misleading or deceptive statement, and requiring court or hearing costs to be borne by the borrower. Similarly, subparagraph (a)(4), in accordance with 10 U.S.C. 987(e)(4), makes it unlawful for any creditor to extend consumer credit to a covered borrower if the "creditor demands *unreasonable notice* from the covered borrower as a condition for legal action." Industry respondents also requested the rule provide a list of what would be considered an "unreasonable notice." In general, the comments with this provision address a fear it is not clear enough. The Department has determined that the provisions provide adequate explanation of "unreasonable notice" and thus has not included specific examples in the final rule of what constitutes "onerous legal notice" or "unreasonable notice." It has concluded, that in so far as necessary, the scope of the provision is more

appropriately determined on a case-by-case basis.

Under § 232.8(a)(5) creditors are generally prohibited from extending consumer credit to a covered borrower if the creditor uses a check or other method of access to the covered borrower's deposit account. Section 232.8(a)(5) also lists certain exceptions to the general prohibition. Accordingly, for credit transactions with an MAPR of 36% or less, the creditor may require the borrower to use an electronic fund transfer to repay a consumer credit transaction, require direct deposit of the consumer's salary as a condition of eligibility for consumer credit, or take a security interest in funds deposited after the extension of credit in an account established in connection with the consumer credit transactions. Creditors must also comply with any other applicable statutes governing the use of electronic fund transfers, savings and direct deposit of consumer's salary. Respondents were generally supportive of allowing borrowers to use electronic fund transfers to pay debt if the MAPR is below 36% as conducive to creating flexible alternatives to lower cost consumer credit and helping stop the cycle of debt exacerbated by payday lending. The Department believes the flexibility that 10 U.S.C. 987(h)(2)(E) provides will encourage beneficial alternative loans designed to assist covered borrowers with financial recovery.

As proposed, § 232.8(a)(5) would have prohibited covered borrowers from using a vehicle title as security for any loan, even if the loan complied with the restrictions, limits and disclosure requirements of Part 232. Industry respondents pointed out this was inconsistent with other provisions treating vehicle-secured loans as covered transactions under these rules. The reference to vehicle secured loans in the proposed § 232.8(a)(5) was inadvertent, and has been corrected in the final rule.

Section 8(a)(7) prohibits creditors from charging a prepayment penalty to covered borrowers. The final regulation does not define what constitutes a prepayment penalty, and the Department expects creditors to rely on existing State and Federal laws for guidance.

*232.9, Penalties and remedies:* This provision incorporates the penalties and enforcement provisions contained in the statute. Section 9 provides, among other things, that any credit agreement subject to the regulation that fails to comply with this regulation is void from inception. It further provides that a creditor or assignee who knowingly violates the regulation shall be subject to certain criminal penalties. No comments were received, and the final rule incorporates the statutory provisions without change.

The statute, however, does not provide explicitly for enforcement of these rules beyond the provisions described above. The Department understands that the federal bank, thrift and credit union regulatory agencies have authority—derived from federal law unique to federally-regulated depository institutions—to enforce these rules with respect to the institutions that they supervise. However, the Department notes that this authority extends to a narrow category of depository institutions that it proposes to cover as "creditors," but it does not extend to other creditors, such as nonbank lenders, that would also be covered creditors and that may be most likely to provide the types of consumer credit restricted by these rules. The Department is concerned that reliance solely on private litigation or criminal prosecution with respect to these other creditors may be insufficient to ensure uniform compliance with these rules with respect to all creditors. The Department understands that the consumer credit covered in the regulation is primarily overseen by state regulatory agencies. Consequently, the Department has made contact with the state regulatory agencies to determine which states plan to enforce the regulation and to determine how best to work with all 50 states on enforcement.

*232.10, Servicemembers Civil Relief Act protections unaffected:* Section 232.10 incorporates the statutory language, no comments were received on this provision and the final rule is unchanged from the proposal.

*232.11, Effective date and transition:* Virtually all respondents who would be subject to the rule requested a delayed effective date so that they would have more time to comply with the rules than the proposed 30-day period. Many respondents suggested six months to a year after publication of the final rule would be more reasonable for making the necessary systems changes. Two industry trade associations commented that it will be easier for creditors to comply by the effective date if the final rule remains as narrow in scope as the proposed rule. A consumer group and state regulators that commented believe that 30 days was sufficient.

The Department recognizes the limited time provided to creditors to react to implement the rules. However, the statute does not provide the Department any flexibility in determining the effective date of the statute, which is October 1, 2007. The Department believes this situation is ameliorated somewhat by the fact that the scope of the proposed rule is narrow and the policy decisions embedded in the final rule mirror to a great extent the provisions contained in the proposed rule. This should have afforded applicable creditors ample time to begin preparing for the requirements under the rule.

*B. Statutory Certification*

Executive Order 12866, "Regulatory Planning and Review"

It has been determined that 32 CFR part 232 is not an economically significant regulatory action. The rule does not:

(1) Have an annual effect to the economy of $100 million or more or adversely and materially affect the economy; a section of the economy; productivity; competition; jobs; the environment; public health or safety; or State, local, or tribal governments or communities;

(2) Create a serious inconsistency or otherwise interfere with an action taken or planned by another Agency;

(3) Materially alter the budgetary impact of entitlements, grants, user fees, or loan programs, or the rights and obligations of recipients thereof; or

(4) Raise novel legal or policy issues arising out of legal mandates, the President's priorities, or the principles set forth in this Executive Order.

Nevertheless, the proposed regulation was submitted to the Office of Management and Budget for review under other provisions of Executive Order 12866 as a significant regulatory action.

Unfunded Mandates Reform Act (Sec. 202, Pub. Law. 104–4)

It has been certified that this rule does not contain a Federal mandate that may result in the expenditure by State, local and tribal governments, in aggregate, or by the private sector, of $100 million or more in any one year.

Public Law 96–354, "Regulatory Flexibility Act" (5 U.S.C. 601)

It has been certified that this rule is not subject to the Regulatory Flexibility Act (5 U.S.C. 601) because it would not, if promulgated, have a significant economic impact on a substantial number of small entities. The North American Industrial Classification (NAIC) for the impacted businesses is 522390—"other financial activities related to credit intermediation." According to the 2002 Economic Census, there are approximately 5,205

small businesses related to this classification, with 3,000 of these small businesses having fewer than 5 employees. These 5,205 businesses represent a portion of the 51,725 potential respondents cited in the Paperwork Reduction Act evaluation.

The limitations and disclosures posed by this part impact only a small percentage of the market served by the industries covered by this part. For example according to the payday lending trade association, Service members and their dependents represent approximately one-to-two percent of the payday lending market. Thus there is not a significant economic impact on a substantial number of small entities.

Public Law 96–511, "Paperwork Reduction Act" (44 U.S.C. Chapter 35)

Section 232.6 of this rule contains information collection requirements. As required by the Paperwork Reduction Act (44 U.S.C. Chapter 35), DoD has submitted an information clearance package to the Office of Management and Budget for review. In response to DoD's invitation in the Proposed Rule to comment on any potential paperwork burden associated with this rule, the following comments were received.

*232.6 Mandatory disclosures:* Section 232.6 describes the disclosures that must be provided to covered borrowers before they become obligated on a consumer credit transaction. This includes the new disclosures established under 10 U.S.C. 987 and also includes disclosures that creditors are already required to provide pursuant to the Federal Reserve Board's Regulation Z, which implements the TILA. Regulation Z contains certain requirements pertaining to the format of the TILA disclosures for closed-end credit transactions, including a requirement that they "shall be grouped together, shall be segregated from everything else, and shall not contain any information not directly related" to the disclosures required under Regulation Z. The Department intends that the disclosures required under this proposal be provided consistent with the format requirements of Regulation Z. Accordingly, the covered borrower identification statement described in § 232.5 and the disclosures provided pursuant to § 232.6(a)(1), (3), and (4) should not be interspersed with the TILA disclosures.

The general rule is that disclosures required by § 232.6(a) (1), (3), and (4) must be provided orally as well as in writing. However, in credit transactions entered into by mail or on the internet, a creditor complies with this requirement if the creditor provides covered borrowers with a toll-free telephone number on or with the written disclosures and the creditor provides oral disclosures when the covered borrower contacts the creditor for this purpose. Consumer groups that commented stated that providing borrowers with a toll-free telephone number would not be sufficient because it places the burden on the borrower instead of the lender. Many industry respondents expressed concern about the costs of providing the disclosures, to include developing software, training employees about the new rules, and updating all their forms. The Department believes providing consumers with a toll-free telephone number to access oral disclosures fulfills the intent of the statute and balances overall considerations for protection with access to credit.

The Department has received several comments about potential disparities in disclosures required by this regulation as opposed to TILA. Many respondents felt that the current APR disclosures are barely understood by consumers and that adding a new MAPR disclosure to the mix will only serve to create more confusion. As with other aspects of the statute, the Department's intention has been to develop a regulation that is consistent with the statutory intent. The Department recognizes the potential confusion inherent in mandating the disclosure of two differing annual percentage rates (the MAPR required by this regulation and the APR required by TILA). As previously stated, the Department is responsible for training Service members and making similar education available for spouses. The differences between APR and MAPR will be added to their training, along with explaining their rights as a covered borrower. Some respondents sought clarification on whether MAPR disclosures would be required in advertising. These same respondents suggest that including MAPRs and APRs in marketing initiatives would be confusing to consumers. Under section 232.6 of the final rule, creditors must provide the required disclosures in writing before consummation of the transaction. Disclosure of the MAPR in advertisements is not required.

Executive Order 13132 Federalism

Executive Order 13132 requires that Executive departments and agencies identify regulatory actions that have significant federalism implications. A regulation has federalism implications if it has substantial direct effects on the States, on the relationship or distribution of power between the Federal Government and the States, or on the distribution of power and responsibilities among various levels of government.

The provisions of this part, as required by 10 U.S.C. 987, override State statutes inconsistent with this part to the extent that state statutes provide lesser protections for covered borrowers than those provided to residents of that State. In this respect, this proposed part, if adopted, would not affect in any manner the powers and authorities that any State may have or affect the distribution of power and responsibilities between Federal and State levels of government. Therefore, the Department has determined that the proposed part has no federalism implications that warrant the preparation of a Federalism Assessment in accordance with Executive Order 13132.

**List of Subjects in 32 CFR Part 232**

Loan programs, Reporting and recordkeeping requirements, Service members.

■ For the reasons set forth in the preamble, Title 32, Code of Federal Regulations is amended by adding part 232 to read as follows:

## PART 232—LIMITATIONS ON TERMS OF CONSUMER CREDIT EXTENDED TO SERVICE MEMBERS AND DEPENDENTS

Sec

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**Authority:** 10 U.S.C. 987.

### § 232.1 Authority, purpose, and coverage.

(a) *Authority.* This part is issued by the Department of Defense to implement 10 U.S.C. 987.

(b) *Purpose.* The purpose of this part is to impose limitations on the cost and terms of certain defined extensions of consumer credit to Service members and their dependents, and to provide additional consumer disclosures for such transactions.

(c) *Coverage.* This part defines the types of consumer credit transactions, creditors, and borrowers covered by the regulation, consistent with the

provisions of 10 U.S.C. 987. In addition, the regulation:

(1) Provides the maximum allowable amount of all charges, and the types of charges, that may be associated with a covered extension of consumer credit;

(2) Requires creditors to disclose to covered borrowers the cost of the transaction as a total dollar amount and as an annualized percentage rate referred to as the Military Annual Percentage Rate or MAPR, which must be disclosed before the borrower becomes obligated on the transaction. The disclosures required by this regulation differ from and are in addition to the disclosures that must be provided to consumers under the Federal Truth in Lending Act;

(3) Provides for the method creditors shall use in calculating the MAPR, and;

(4) Contains such other criteria and limitations as the Secretary of Defense has determined appropriate, consistent with the provisions of 10 U.S.C. 987.

**§ 232.2 Applicability.**

This part applies to consumer credit extended by creditors to a covered borrower, as those terms are defined in this part.

**§ 232.3 Definitions.**

Terms used in this part are defined as follows:

(a) *Closed-end credit* means consumer credit other than "open-end credit" as that term is defined in Regulation Z (Truth in Lending), 12 CFR part 226.

(b) *Consumer credit* means closed-end credit offered or extended to a covered borrower primarily for personal, family or household purposes, as described in paragraph (b)(1) of this section.

(1) Except as provided in paragraph (b)(2) of this section, consumer credit means the following transactions:

(i) *Payday loans.* Closed-end credit with a term of 91 days or fewer in which the amount financed does not exceed $2,000 and the covered borrower:

(A) Receives funds from and incurs interest and/or is charged a fee by a creditor, and contemporaneously with the receipt of funds, provides a check or other payment instrument to the creditor who agrees with the covered borrower not to deposit or present the check or payment instrument for more than one day, or;

(B) Receives funds from and incurs interest and/or is charged a fee by a creditor, and contemporaneously with the receipt of funds, authorizes the creditor to initiate a debit or debits to the covered borrower's deposit account (by electronic fund transfer or remotely created check) after one or more days. This provision does not apply to any right of a depository institution under statute or common law to offset indebtedness against funds on deposit in the event of the covered borrower's delinquency or default.

(ii) *Vehicle title loans.* Closed-end credit with a term of 181 days or fewer that is secured by the title to a motor vehicle, that has been registered for use on public roads and owned by a covered borrower, other than a purchase money transaction described in paragraph (b)(2)(ii) of this section.

(iii) *Tax refund anticipation loans.* Closed-end credit in which the covered borrower expressly grants the creditor the right to receive all or part of the borrower's income tax refund or expressly agrees to repay the loan with the proceeds of the borrower's refund.

(2) For purposes of this part, consumer credit does not mean:

(i) Residential mortgages, which are any credit transactions secured by an interest in the covered borrower's dwelling, including transactions to finance the purchase or initial construction of a dwelling, refinance transactions, home equity loans or lines of credit, and reverse mortgages;

(ii) Any credit transaction to finance the purchase or lease of a motor vehicle when the credit is secured by the vehicle being purchased or leased;

(iii) Any credit transaction to finance the purchase of personal property when the credit is secured by the property being purchased;

(iv) Credit secured by a qualified retirement account as defined in the Internal Revenue Code; and

(v) Any other credit transaction that is not consumer credit extended by a creditor, is an exempt transaction, or is not otherwise subject to disclosure requirements for purposes of Regulation Z (Truth in Lending), 12 CFR part 226.

(c) *Covered borrower* means a person with the following status at the time he or she becomes obligated on a consumer credit transaction covered by this part:

(1) A regular or reserve member of the Army, Navy, Marine Corps, Air Force, or Coast Guard, serving on active duty under a call or order that does not specify a period of 30 days or fewer, or such a member serving on Active Guard and Reserve duty as that term is defined in 10 U.S.C. 101(d)(6), or

(2) The member's spouse, the member's child defined in 38 U.S.C. 101(4), or an individual for whom the member provided more than one-half of the individual's support for 180 days immediately preceding an extension of consumer credit covered by this part.

(d) *Credit* means the right granted by a creditor to a debtor to defer payment of debt or to incur debt and defer its payment.

(e) *Creditor* means a person who is engaged in the business of extending consumer credit with respect to a consumer credit transaction covered by this part. For the purposes of this section, "person" includes a natural person, organization, corporation, partnership, proprietorship, association, cooperation, estate, trust, and any other business entity and who otherwise meets the definition of "creditor" for purposes of Regulation Z.

(f) *Dwelling* means a residential structure that contains one to four units, whether or not the structure is attached to real property. The term includes an individual condominium unit, cooperative unit, mobile home, and manufactured home.

(g) *Electronic fund transfer* (EFT) has the same meaning for purposes of this part as in Regulation E (Electronic Fund Transfers) issued by the Board of Governors of the Federal Reserve System, 12 CFR part 205.

(h) *Military annual percentage rate* (MAPR). The MAPR is the cost of the consumer credit transaction expressed as an annual rate. The MAPR shall be calculated based on the costs in this definition but in all other respects it shall be calculated and disclosed following the rules used for calculating the Annual Percentage Rate (APR) for closed-end credit transactions under Regulation Z (Truth in Lending), 12 CFR part 226.

(1) The MAPR includes the following cost elements associated with the extension of consumer credit to a covered borrower if they are financed, deducted from the proceeds of the consumer credit, or otherwise required to be paid as a condition of the credit:

(i) Interest, fees, credit service charges, credit renewal charges;

(ii) Credit insurance premiums including charges for single premium credit insurance, fees for debt cancellation or debt suspension agreements; and

(iii) Fees for credit-related ancillary products sold in connection with and either at or before consummation of the credit transaction.

(2) The MAPR does not include:

(i) Fees or charges imposed for actual unanticipated late payments, default, delinquency, or similar occurrence;

(ii) Taxes or fees prescribed by law that actually are or will be paid to public officials for determining the existence of, or for perfecting, releasing, or satisfying a security interest;

(iii) Any tax levied on security instruments or documents evidencing indebtedness if the payment of such

taxes is a requirement for recording the instrument securing the evidence of indebtedness; and

(iv) Tax return preparation fees associated with a tax refund anticipation loan, whether or not the fees are deducted from the loan proceeds.

(i) *Regulation Z* means any of the rules, regulations, or interpretations thereof, issued by the Board of Governors of the Federal Reserve System to implement the Truth in Lending Act, as amended, from time to time, including any interpretation or approval issued by an official or employee duly authorized by the Board of Governors of the Federal Reserve System to issue such interpretations or approvals. Words that are not defined in this regulation have the meanings given to them in Regulation Z (12 CFR part 226) issued by the Board of Governors of the Federal Reserve System (the "Board"), as amended from time to time, including any interpretation thereof by the Board or an official or employee of the Federal Reserve System duly authorized by the Board to issue such interpretations. Words that are not defined in this regulation or Regulation Z, or any interpretation thereof, have the meanings given to them by State or Federal law, or contract.

**§ 232.4 Terms of consumer credit extended to covered borrowers.**

(a) Neither a creditor who extends consumer credit to a covered borrower nor an assignee of the creditor shall require the member or dependent to pay a military annual percentage rate (MAPR) with respect to such extension of 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 part.

(b) A creditor described in paragraph (a) of this section or an assignee may not impose an MAPR greater than 36 percent in connection with an extension of consumer credit to a covered borrower.

**§ 232.5 Identification of covered borrower.**

(a) This part shall not apply to a consumer credit transaction if the conditions described in paragraphs (a)(1) and (a)(2) of this section are met:

(1) Prior to becoming obligated on the transaction, each applicant is provided with a clear and conspicuous "covered borrower identification statement" substantially similar to the following statement and each applicant signs the statement indicating that he or she is or is not a covered borrower:

Federal law provides important protections to active duty members of the Armed Forces and their dependents. To ensure that these protections are provided to eligible applicants, we require you to sign one of the following statements as applicable:

I AM a regular or reserve member of the Army, Navy, Marine Corps, Air Force, or Coast Guard, serving on active duty under a call or order that does not specify a period of 30 days or fewer.

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I AM a dependent of a member of the Armed Forces on active duty as described above, because I am the member's spouse, the member's child under the age of eighteen years old, or I am an individual for whom the member provided more than one-half of my financial support for 180 days immediately preceding today's date.

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—OR—

I AM NOT a regular or reserve member of the Army, Navy, Marine Corps, Air Force, or Coast Guard, serving on active duty under a call or order that does not specify a period of 30 days or fewer (or a dependent of such a member).

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Warning: It is important to fill out this form accurately. Knowingly making a false statement on a credit application is a crime

(2) The creditor has not determined, pursuant to the optional verification procedures in paragraphs (b) or (c) of this section, that any such applicant is a covered borrower.

(b) The creditor may, but is not required to, verify the status of an applicant as a covered borrower by requesting the applicant to provide a current (previous month) military leave and earning statement, or a military identification card (DD Form 2 for members, DD Form 1173 for dependents), as described in DoD Instruction 1003.1, *Identification (ID) Cards for Members of the Uniformed Services, Their Dependents, and Other Eligible Individuals*, December 5, 1997. Upon such request, activated members of the National Guard or Reserves shall also provide a copy of the military orders calling the covered member to military service and any orders further extending military service.

(c) The creditor may, but is not required to, verify the status of an applicant as a covered borrower by accessing the information available at *http://www.dmdc.osd.mil/mla/owa/home*. Searches require the service member's full name, Social Security number, and date of birth.

(d) This part shall not apply to a consumer credit transaction in which the creditor rolls over, renews, repays, refinances, or consolidates consumer credit in accordance with § 232.8(a)(1) if § 232.5(a)(1) and § 232.5(a)(2) applied to the previous transaction.

**§ 232.6 Mandatory loan disclosures.**

(a) *Required information.* With respect to any extension of consumer credit (including any consumer credit originated or extended through the internet) to a covered borrower, a creditor shall provide to the member or dependent the following information clearly and conspicuously before consummation of the consumer credit transaction:

(1) The MAPR applicable to the extension of consumer credit, and the total dollar amount of all charges included in the MAPR.

(2) Any disclosures required by Regulation Z (Truth in Lending), 12 CFR part 226.

(3) A clear description of the payment obligation of the covered borrower, as applicable. A payment schedule provided pursuant to paragraph (a)(2) of this section satisfies this requirement.

(4) A statement that "Federal law provides important protections to regular or reserve members of the Army, Navy, Marine Corps, Air Force, or Coast Guard, serving on active duty under a call or order that does not specify a period of 30 days or fewer, and their dependents. Members of the Armed Forces and their dependents may be able to obtain financial assistance from Army Emergency Relief, Navy and Marine Corps Relief Society, the Air Force Aid Society, or Coast Guard Mutual Aid. Members of the Armed Forces and their dependents may request free legal advice regarding an application for credit from a service legal assistance office or financial counseling from a consumer credit counselor."

(b) *Method of disclosure.* (1) *Written disclosures.* The creditor shall provide the disclosures required by paragraph (a) in writing in a form the covered borrower can keep.

(2) *Oral disclosures.* The creditor also shall provide the disclosures required by paragraphs (a)(1), (a)(3) and (a)(4) of this section orally before consummation. In mail and internet transactions, the creditor satisfies this requirement if it provides a toll-free telephone number on or with the written disclosures that consumers may use to obtain oral disclosures and the creditor provides oral disclosures when the covered borrower contacts the creditor for this purpose.

(c) *When disclosures are required for refinancing or renewal of covered loan.* The refinancing or renewal of a covered loan requires new disclosures under § 232.6 only when the transaction

would be considered a new transaction that requires disclosures under the Truth in Lending Act, as implemented by the Federal Reserve Board's Regulation Z, 12 CFR part 226.

**§ 232.7 Preemption.**

(a) *Inconsistent laws.* 10 U.S.C. 987 as implemented by this part preempts any State or Federal law, rule or regulation, including any State usury law, to the extent such law, rule or regulation is inconsistent with this part, except that any such law, rule or regulation is not preempted by this part to the extent that it provides protection to a covered borrower greater than those protections provided by 10 U.S.C. 987 and this part.

(b) Different treatment under State law of covered borrowers is prohibited. States may not:

(1) Authorize creditors to charge covered borrowers rates of interest that are higher than the legal limit for residents of the State, or

(2) Permit the violation or waiver of any State consumer lending protection that is for the benefit of residents of the State on the basis of the covered borrower's nonresident or military status, regardless of the covered borrower's domicile or permanent home of record, provided that the protection would otherwise apply to the covered borrower.

**§ 232.8 Limitations.**

(a) 10 U.S.C. 987 makes it unlawful for any creditor to extend consumer credit to a covered borrower with respect to which:

(1) The creditor rolls over, renews, repays, refinances, or consolidates any consumer credit extended to the covered borrower by the same creditor with the proceeds of other consumer credit extended by that creditor to the same covered borrower, unless the new transaction results in more favorable terms to the covered borrower, such as a lower MAPR. This part shall not apply to a transaction permitted by this paragraph when the same creditor extends consumer credit to a covered borrower to refinance or renew an extension of credit that was not covered by this part because the consumer was not a covered borrower at the time of the original transaction.

(2) The covered borrower is required to waive the covered 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 (50 U.S.C. App. 10 U.S.C. 527 *et seq.*).

(3) The creditor requires the covered borrower to submit to arbitration or imposes other onerous legal notice provisions in the case of a dispute.

(4) The creditor demands unreasonable notice from the covered 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 covered borrower, except that, in connection with a consumer credit transaction with an MAPR consistent with § 232.4(b):

(i) The creditor may require an electronic fund transfer to repay a consumer credit transaction, unless otherwise prohibited by Regulation E (Electronic Fund Transfers) 12 CFR part 205;

(ii) The creditor may require direct deposit of the consumer's salary as a condition of eligibility for consumer credit, unless otherwise prohibited by law; or

(iii) The creditor may, if not otherwise prohibited by applicable law, take a security interest in funds deposited after the extension of credit in an account established in connection with the consumer credit transaction.

(6) The creditor requires as a condition for the extension of consumer credit that the covered borrower establish an allotment to repay the obligation.

(7) The covered borrower is prohibited from prepaying the consumer credit or is charged a penalty fee for prepaying all or part of the consumer credit.

(b) For purposes of this section, an assignee may not engage in any transaction or take any action that would be prohibited for the creditor.

**§ 232.9 Penalties and remedies.**

(a) *Misdemeanor.* A creditor or assignee who knowingly violates 10 U.S.C. 987 as implemented by this part shall be fined as provided in title 18, United States Code, or imprisoned for not more than one year, or both.

(b) *Preservation of other remedies.* The remedies and rights provided under 10 U.S.C. 987 as implemented by this part are in addition to and do not preclude any remedy otherwise available under State or Federal law or regulation to the person claiming relief under the statute, including any award for consequential damages and punitive damages.

(c) *Contract void.* Any credit agreement, promissory note, or other contract with a covered borrower that fails to comply with 10 U.S.C. 987 as implemented by this regulation or which contains one or more provisions prohibited under 10 U.S.C. 987 as implemented by this regulation is void from the inception of the contract.

(d) *Arbitration.* Notwithstanding 9 U.S.C. 2, or any other Federal or State law, rule, or regulation, no agreement to arbitrate any dispute involving the extension of consumer credit to a covered borrower pursuant to this part shall be enforceable against any covered borrower, or any person who was a covered borrower when the agreement was made.

**§ 232.10 Servicemembers Civil Relief Act protections unaffected.**

Nothing in this part may be construed to limit or otherwise affect the applicability of Section 207 and any other provisions of the Servicemembers Civil Relief Act (50 U.S.C. App. 527).

**§ 232.11 Effective date and transition.**

Applicable consumer credit—This part shall only apply to consumer credit that is extended to a covered borrower and consummated on or after October 1, 2007.

Dated: August 27, 2007.

**L.M. Bynum,**

*Alternate OSD Federal Register Liaison Officer, DoD.*

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