

Pawnshop Advisory Bulletin: Military Lending Act Rule

Starting October 3, 2016, pawnshops are required to comply with the U.S. Department of Defense's recently amended Military Lending Act (MLA) Rule. This bulletin describes some of the MLA Rule's requirements for Texas pawnshops.

This bulletin is just a summary. Pawnshops must read and familiarize themselves with the text of the MLA Rule, which is located at title 32, part 232 of the Code of Federal Regulations.

- The text of the MLA Rule is available at pages 43,606–43,612 of:
<https://www.gpo.gov/fdsys/pkg/FR-2015-07-22/pdf/2015-17480.pdf>
- The text of DOD's interpretive rule with additional details is available at:
<https://www.gpo.gov/fdsys/pkg/FR-2016-08-26/pdf/2016-20486.pdf>

This bulletin reflects the OCCC's current understanding of the MLA Rule. The MLA Rule is a federal rule, not an OCCC rule. If the OCCC receives updated guidance from the Department of Defense (DOD) or another federal agency, it will revise this bulletin.

GENERAL REQUIREMENTS

1. Does the MLA Rule apply to Texas pawnshops?

Yes, the MLA Rule applies to Texas pawnshops. Starting October 3, 2016, pawnshops must comply with the MLA Rule. The rule generally covers consumer credit transactions, and there is no exception for pawnshops. 32 CFR 232.2(a)(1). DOD has acknowledged that the rule applies to pawnshops. 80 Fed. Reg. 43,605.

2. What are the general requirements of the MLA Rule?

The MLA Rule defines certain members of the military and their dependents as "covered borrowers." If the borrower is a covered borrower, then the following requirements apply:

- The military annual percentage rate (MAPR) must be 36% or less.
- The pawnshop must provide a mandatory loan disclosure for covered borrowers.
- The loan documents cannot include a waiver of the borrower's protections under state or federal law.
- The loan documents cannot require arbitration.
- The loan documents cannot require unreasonable notice as a condition for legal action.
- The pawnshop cannot use a check or other method to access a deposit, savings, or other financial account maintained by the borrower (with some limited exceptions).
- The pawnshop cannot charge a prepayment penalty (a prepayment penalty would also be prohibited under Section 371.159(a) of the Texas Finance Code).
- The pawnshop cannot accept a motor vehicle title as security.
32 CFR 232.4, 232.6, 232.8.

DETERMINING COVERED BORROWER STATUS

3. Who is a covered borrower?

There are two types of covered borrowers: a covered member of the armed forces, and a dependent of a covered member. 32 CFR 232.3(g)(1).

A “covered member” of the armed forces is a member who is serving on:

- active duty under a call that does not specify a period of 30 days or fewer, or
- active guard and reserve duty. 32 CFR 232.3(g)(2).

A “dependent” of a covered member means:

- the covered member’s spouse,
- the covered member’s children up to age 21 (or age 23 for certain college-enrolled children),
- the covered member’s parent or parent-in-law who is dependent on the member for over one-half of support and residing in the member’s household,
- a person in the covered member’s legal custody under 12 USC 1072(2)(l), or
- certain other people who are dependent on the covered member as described in 12 USC 1072(2)(D) or (E). 32 CFR 232.3(g)(3).

4. How do I determine who is a covered borrower? What is the safe harbor?

The MLA Rule allows a creditor to use its own method to determine whether a prospective borrower is a covered borrower. 32 CFR 232.5(a).

The MLA Rule provides a safe harbor if a creditor determines covered-borrower status by using the MLA website at <https://mla.dmdc.osd.mil/>, or if the creditor gets a consumer report that includes information from DOD’s MLA database (such as a credit report). “Safe harbor” means that a creditor can conclusively determine a borrower’s status by using the MLA website or an appropriate consumer report. 32 CFR 232.5(b)(2). To benefit from the safe harbor, the creditor must determine the consumer’s status at or before the time of the transaction, and must maintain a record of the status. 32 CFR 232.5(b)(3).

Although the MLA Rule allows creditors to use methods other than the MLA website or a consumer report, these methods do not provide a safe harbor. This means that if a pawnshop uses another method (e.g., having borrowers fill out a written form), the pawnshop is responsible for violations of the rule. Not using the MLA website opens a pawnshop to substantial risks.

5. Should I have a written policy for determining who is a covered borrower?

Yes, each pawnshop should have a written policy for how it determines whether a prospective borrower is a covered borrower.

6. Instead of checking the MLA website, can I just get a written statement from each borrower about whether they are a covered borrower?

The MLA Rule allows pawnshops to choose a method, so pawnshops could choose to have a policy of getting a written statement from each borrower. However, having a borrower sign a statement does not comply with the safe harbor. If a pawnshop does not comply with the MLA Rule's safe harbor, it risks liability and penalties. The OCCC encourages pawnshops to carefully consider what their system of compliance and conduct will be.

7. How do I use the MLA website?

The MLA website is located at <https://mla.dmdc.osd.mil/>

To make a request for whether a person is a covered borrower, the pawnshop will need to enter the person's last name, date of birth, and Social Security number.

8. What should I do if the MLA website has delays or technical difficulties?

The MLA Website User's Guide, which is available on the website's main page, provides troubleshooting tips and FAQs. The MLA website is maintained by the Defense Manpower Data Center (DMDC). You can e-mail DMDC's MLA HelpDesk at dodhra.dodc-mb.dmdc.mbx.MLA@mail.mil

9. What if a borrower won't give me a Social Security number?

If your policy is to check the MLA website before making a loan, then you will not be able to make the loan until the borrower provides a Social Security number. Without a Social Security number, a pawnshop cannot check the MLA website to comply with the safe harbor, and the pawnshop runs the risk of liability.

10. On a previous loan, I checked the MLA website and confirmed that the borrower was not a covered borrower. Do I need to re-check the same borrower for a new loan?

To comply with the safe harbor, yes. The results of a covered borrower check on the MLA website apply to a specific transaction. 32 CFR 232.5(b)(3). In order to comply with the safe harbor, a pawnshop must re-check a borrower for each new transaction that the borrower enters, in order to determine whether the borrower is a covered borrower as of the date of the new transaction. For purposes of this requirement, an extension of a pawn loan using a memorandum of extension is not a new transaction, but a renewal of a pawn loan is a new transaction.

11. Is there a limitation on when I am allowed to access the MLA website?

Yes. The MLA Rule generally prohibits creditors from using the MLA website for a historic lookback after a consumer has entered a transaction. After a consumer enters a transaction, the creditor may not obtain information from the MLA database "to ascertain whether a consumer had been a covered borrower as of the date of that transaction or as of the date

that account was established.” 32 CFR 232.5(b)(2)(B). In its interpretive rule, DOD stated that a creditor could access the website for other purposes, “such as determining whether a previously covered borrower retains that status.” 81 Fed. Reg. 58,843.

COMPLYING WITH REQUIREMENTS FOR COVERED BORROWERS

12. How do I ensure that the MAPR is 36% or less?

If a pawnshop makes a pawn loan to a covered borrower, the military annual percentage rate (MAPR) must be 36% or less. 32 CFR 232.4(b). The pawn loan must also comply with any stricter limitations under state law. 32 CFR 232.4(a)(2).

In order for a pawn loan to comply with the MLA Rule’s MAPR requirements for covered borrowers, the pawnshop must ensure that both of the following requirements are met:

- the pawn service charge cannot be more than 3% of the amount financed, and
- the loan must fully comply with Chapter 371 of the Finance Code, including limitations on the pawn service charge, limitations on other charges, the one-month term requirement, and disclosure requirements.

For example, if a pawnshop makes a \$200 loan to a covered borrower, the pawn service charge is limited to \$6.

The MAPR is similar to the APR under the federal Truth in Lending Act and Regulation Z. The MAPR includes certain additional charges that are normally not included in the APR, such as charges for certain voluntary insurance products. 32 CFR 232.4(c)(1). However, Section 371.159(a) of the Finance Code prohibits these additional charges for pawn loans. If a pawnshop properly computes the pawn service charge under Chapter 371, the MAPR should be equal to the APR.

For larger pawn loans, Section 371.159(c)(3)-(4) of the Finance Code provides limitations that are stricter than the MLA Rule’s 36% MAPR limitation.

- For pawn loans in the bracket above \$1,340 up to \$2,010, the Finance Code currently limits the pawn service charge to 2.5% of the amount financed.
- For pawn loans in the bracket above \$2,010 up to \$16,750, the Finance Code currently limits the pawn service charge to 1% of the amount financed.

13. What is the mandatory disclosure for covered borrowers?

Before making a loan to a covered borrower, a creditor must provide the following required disclosure (or a substantially similar disclosure) under 32 CFR 232.6(c)(3):

“Federal law provides important protections to members of the Armed Forces and their dependents relating to extensions of consumer credit. In general, the cost of consumer credit to a member of the Armed Forces and his or her dependent may not exceed an annual percentage rate of 36 percent. This rate must include, as applicable to the credit transaction or account: The costs associated with credit insurance premiums; fees for ancillary products sold in connection with the credit transaction;

any application fee charged (other than certain application fees for specified credit transactions or accounts); and any participation fee charged (other than certain participation fees for a credit card account).”

14. When and how do I have to provide the mandatory disclosure to a covered borrower?

The disclosure must be provided when the borrower enters the transaction or earlier. 32 CFR 232.6(a). The creditor must provide the disclosure both orally and in writing. 32 CFR 232.6(d). Pawnshops may either include the mandatory disclosure on the pawn ticket or provide it as a separate written form.

15. On a previous loan, I provided the mandatory disclosure to a covered borrower. Do I need to provide another disclosure if the same borrower returns for a new loan?

Yes. If a pawnshop provided the disclosure to a covered borrower for a previous pawn transaction, and the covered borrower is going to enter a new transaction, then the pawnshop must provide a new disclosure to the borrower. For purposes of this requirement, an extension of a pawn loan using a memorandum of extension is not a new transaction, but a renewal of a pawn loan is a new transaction.

16. Can I make a pawn loan to a covered borrower where the collateral is a motor vehicle?

No. The MLA Rule generally prohibits creditors from making loans secured by motor vehicles to covered borrowers. 32 CFR 232.8(f).

COMPLIANCE DATE AND OTHER REQUIREMENTS

17. When am I required to comply with the MLA Rule?

Pawnshops must comply with the MLA Rule starting October 3, 2016. 32 CFR 232.13(a).

18. Does the MLA Rule apply to a pawn loan entered before October 3, and extended by a memorandum of extension signed after October 3?

No. The MLA Rule applies to loans consummated on or after October 3. 32 CFR 232.13(a). A transaction is consummated when a consumer enters a new credit obligation under state law. If a borrower enters a pawn transaction before October 3 and later extends the loan, the extension does not create a new consummation that triggers the MLA Rule.

However, if a consumer renews a previous pawn loan on or after October 3, then the MLA Rule applies. A renewal is a consummation of a new transaction.

This answer is based on the OCC’s current understanding of the MLA Rule. The MLA Rule does not define the term “consummated.” The MLA Rule states that terms not defined in the MLA Rule have the same meaning as terms in Regulation Z. 32 CFR 232.3(s). Under Regulation Z, “consummation” means the time that a consumer becomes contractually

obligated on a credit transaction under state law. 12 CFR 1026.2(a)(13). Based on these definitions, the OCC's understanding is that a new pawn loan or a renewal would be a consummation, but an extension of an existing pawn loan would not be a consummation. If the OCC receives updated guidance from DOD, it will update this bulletin.

19. What are the penalties for violating the MLA Rule?

Violating the MLA Rule is a criminal offense (misdemeanor) under federal law, punishable by up to a year in prison. 32 CFR 232.9(a).

There is also civil liability for violating the MLA Rule under 32 CFR 232.9(c)-(e):

- The loan contract is void.
- The borrower can sue for actual damages of at least \$500.
- The borrower can sue for equitable relief, court costs, and attorney's fees.

There is a limitations period for a borrower to bring a civil action. A borrower must bring an action no later than the earlier of: (1) two years from the date of the borrower's discovery of the violation, or (2) five years from the date of the violation. 32 CFR 292.9(e)(5).

20. What records relating to the MLA Rule do I have to keep? How long do I have to keep them?

The Texas Finance Commission recently adopted amendments to the OCC's recordkeeping rule for pawnshops, located at Title 7, Section 85.402(h) of the Texas Administrative Code. Under the amended recordkeeping rule, pawnshops must keep any mandatory disclosures and any records they obtain in determining whether a borrower is a covered borrower. The amended recordkeeping rule went into effect on January 1, 2017.

The recordkeeping rule does not require a particular form for these records, but pawnshops must maintain any records they create or obtain in the process of determining whether a borrower is a covered borrower. This includes a printout or saved electronic copy of any search results from the MLA website, or results from a consumer reporting agency that provides an MLA search function.

The OCC's recordkeeping rule requires pawnshops to keep these records for two years after the last recorded event (the same period that pawnshops are required to keep the pawn ticket). Pawnshops can keep the records for a longer period if they choose.