

## **SOLDIERS' AND SAILORS' CIVIL RELIEF ACT—WHAT EVERY BANK SHOULD KNOW**

In 1940, on the verge of United States involvement in World War II, Congress passed the Soldiers' and Sailors' Civil Relief Act (the "Act"). Although Congress has amended the Act, its principal purpose remains the same today. The purpose of the Act is to help service personnel devote their full attention to their military role by minimizing the distraction of financial or other legal burdens. The Act protects members of the military from the enforcement of certain legal obligations incurred prior to active duty which the serviceman is unable to meet due either to his absence from home or from the financial hardship caused by lower military pay.

This article will explore the aspects of the Act most relevant to banks. The process will begin by identifying the people eligible for relief under the Act. Next, this article will look at the types of obligations which qualify for relief. Finally, this article will look at specific types of relief banks must give eligible customers.

### ***Who is Eligible?***

The Act extends protection to all members of the armed forces including the Army, Air Force, Navy, Marines and Coast Guard who are on *active duty*. In other words, a member of the National Guard or Reserves who the military has not called to active duty is not eligible for the protection of the Act until the military calls the serviceman to active duty. As a general rule, a court-martialed or AWOL serviceman does not qualify.

The Act also protects certain non-military personnel. For instance, Public Health Service personnel who are on active service with the military receive the same protection

as regular military personnel. The Act's protection also extends to the spouse and dependent children of a serviceman. However, the spouse or dependent child must be "materially affected" by the military service before the Act will protect them. The spouse or dependent child must apply to a court for an order extending the Act's protection. A court will grant the order unless, in the court's opinion, the military service does not materially impair the ability of the dependent to comply with the terms of an obligation. The Act can even go so far as to protect non-dependents. Courts have the discretion to extend the Act to protect other persons who are primarily or secondarily liable on obligations of a serviceman such as co-signors and guarantors.

Persons wishing to claim the benefits of the Act must provide some kind of documentation showing their active duty status and the date such status began. Unfortunately, there is no standard form such proof must take, and it may vary between military branches. Examples of appropriate documents include duty orders, enlistment documents or certification letters from the military.

Interestingly, the Act does not protect an otherwise qualifying member of the military if the active duty military service has no material effect on the serviceman. The burden of proving no material effect is on the bank. A bank must bring a lawsuit alleging the serviceman has suffered no adverse material effect. However, the Act would suspend any such lawsuit until the serviceman returns from active duty. In other words, a bank may sue the serviceman, but then must provide the serviceman with all of the benefits of the Act until the serviceman returns. Once the serviceman returns, the bank has the burden of showing the serviceman did not suffer an adverse material effect by his service. If the bank wins, then the bank can recover the money the serviceman would have paid

but for the Act. One of these lawsuits is extremely unlikely to succeed and a bank should only attempt one after a great deal of thought, especially considering courts tend to interpret the Act very liberally. However, success is not unheard-of. For example, in one case a lender successfully sued a military doctor who continued to receive millions in investment income during active duty.

### ***What Types of Obligations Are Eligible for Relief?***

The Act only applies to obligations incurred *before* the serviceman went on active duty. The Act does not effect obligations incurred while on active duty. Essentially, the Act relieves the serviceman from nearly all contractual obligations and legal proceedings incurred or begun before active duty during the time the serviceman is on active duty. For the most part, the Act does not eliminate obligations or permanently dismiss legal proceedings. Rather, the Act temporarily delays enforcement.

Certain obligations are not eligible for relief. For instance, the Act does not cover federally guaranteed student loans (though a serviceman may be eligible for a deferment outside of the Act based on economic hardship). Also, the Act does not completely apply to child support and paternity claims.

### ***What Types of Relief Must a Bank Give?***

The Act requires banks to give a variety of relief to a serviceman. This relief includes an interest rate cap, limits from judicial proceedings and releases from leases. As a general rule, the relief continues the entire time the serviceman is on active duty and for sixty days thereafter, though, as noted below, there are several exceptions.

## Interest Rate Cap

The Act limits the interest rate to 6% per year on all loans and debts of a serviceman including credit card debt (but with the before mentioned exception of student loan debt). The interest rate cap is effective immediately upon beginning active duty, even if the serviceman does not notify the bank of his status. Banks must make adjustments to a serviceman's account retroactive to the first day of active duty even if doing so means giving a refund. A bank must forgive interest charges above 6% and cannot collect the difference after the serviceman leaves active duty (though, the bank can raise the interest rate back up to the regular rate sixty days after the serviceman leaves active duty).

For amortized loans such as home mortgages, the bank must recalculate the amount due per payment period based on the 6% cap and reduce the payments accordingly. In other words, the bank must decrease the amount due for each payment, which means banks cannot charge the pre-active duty amount and apply more of the payment to principal and less to interest. For purposes of this requirement, the Act defines interest as including nearly all fees charged such as service or renewal fees (bona fide insurance costs are not interest).

For certain government assisted loans, such as FHA-insured mortgages, the assistance must be reanalyzed if the Act decreases the interest rate on the loan. In some cases, this may mean the government will suspend the assistance during the period of active duty. If the bank applies the interest rate reduction retroactively because the serviceman did not immediately notify the bank of the serviceman's active duty status, then the bank must return any over-billed subsidy to the government.

### Judicial Proceedings

The Act grants a judicial stay for almost any court proceeding against a serviceman. Furthermore, a court may not enter a default judgment without requiring a sworn affidavit, and the court may require posting a substantial bond. Banks may not foreclose on or seize any property during active duty or for three months thereafter without a court order. Furthermore, banks may not impose penalties or repossess property securing installment loan contracts without a court order. If a bank repossesses property during active duty service, then the parties involved could face up to a year in prison plus a \$1,000 fine.

During active duty, the Act automatically tolls statutes of limitation and the statutory redemption period for property sold at a foreclosure sale. Active duty service also constitutes a disability for purposes of tolling the statute of limitations on adverse possession of real estate.

### Termination of Leases

Upon written notice, a serviceman may terminate leases for property occupied for dwelling, professional or business purposes without incurring any form of penalty and without a court order. A landlord must return any unearned portion of prepaid rent and must return the security deposit. Automobile leases are particularly difficult to interpret depending on whether the lease includes an option to purchase. However, generally speaking, a serviceman can also terminate an automobile lease. If the rent on a dwelling is less than \$1,200 a month, then a landlord cannot evict the dependents of a serviceman without judicial consent.

## Taxes

If a serviceman can show his ability to pay any state or federal tax is "materially affected," then the Act will defer collection of the tax for up to six months after active duty. The government may not charge any interest or penalty for the nonpayment of deferred taxes.

## Life Insurance

If a serviceman can no longer pay the premiums on a commercial life insurance policy, then the government may guarantee the payment of the premiums, or require the insurance company to characterize the unpaid premium as a loan against the policy. After active duty, the serviceman may be given up to two years to pay back the premiums.

## *The Future*

In recent months the House of Representatives and the Senate have both proposed a number of amendments to the Act. One key proposal would extend the interest rate cap to student loans. Another amendment is aimed at giving a tax break to servicemen who have to sell a home twice within a two year period as a result of being relocated in the military. Other amendments are designed to extend the Act's timeframes to give servicemen more time after returning from active duty before civil obligations are reinstated.

Most likely, the House and the Senate will reach a compromise bill to modernize and expand the Act. If this happens, and the President gives his approval, then the Act will

become even more important than it already is. A bank should remain alert to future changes to ensure its policies change with updates in the law.<sup>1</sup>

### ***Conclusion***

This article presents the highlights of the Soldiers' and Sailors' Civil Relief Act. However, this article does not cover the full-spectrum of possible issues. In dealing with an active duty serviceman, the key point to focus on is the fact Congress designed the Act to protect the nation's service personnel from suffering a material adverse financial effect as a result of his or her military service. A bank should remember this goal and work to relieve a serviceman from as much hardship as possible. When faced with an issue involving an active duty serviceman, it is always best to seek appropriate legal consultation to decide an appropriate course of action.

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<sup>1</sup> The proposed amendments include H.R. 2721, H.R. 1411, H.R. 621, H.R. 2576, H.R. 3024, H.R. 3357, H.R. 100, S. 806, S. 792 and S. 1136.