

THOMAS J. MILLER  
ATTORNEY GENERAL



CONSUMER PROTECTION DIVISION

Address Reply To:  
Hoover Bldg., 1305 E. Walnut  
Des Moines, Iowa 50319  
Telephone: 515-281-5926  
Toll Free: 888-777-4590 (In Iowa)  
Fax: 515-281-6771  
[www.IowaAttorneyGeneral.org](http://www.IowaAttorneyGeneral.org)

## Department of Justice

July 9, 2012

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RE: De Minimis Exception for Rebates on Overpaid Simple Interest Contracts

Dear Mr. Kinsel:

This letter is in response to your inquiry of May 1, 2012, to Rodney Reed regarding the requirements under Iowa law for rebates owed to consumers who overpay on simple interest motor vehicle loan or installment sale contracts. Mr. Reed forwarded your questions to me to answer as Deputy Administrator of the Iowa Consumer Credit Code. Bear in mind that this letter represents only an informal review by our office based on the information you provided; it is not a formal opinion of the Attorney General nor is it legal advice.

Based on your letter, there do not appear to be any specific facts underlying this inquiry. Your hypothetical question is whether lenders have an obligation to refund to a consumer any amount the consumer overpays pursuant to a simple (or actuarial) interest contract, as opposed to a precomputed interest contract and, if so, whether Iowa law provides a de minimis exception in cases where consumers overpay by only a small amount. In addition, you have posed the questions of whether there may be a higher de minimis exception for prepayment overpayments on simple interest contracts than on precomputed interest contracts and whether lenders may include contract language specifying de minimis limits on prepayment overpayment refunds on simple interest contracts.

The Iowa Consumer Credit Code ("ICCC") governs consumer credit transactions in the state, including the motor vehicle or installment sale contracts to which you referred. The ICCC provides, in Iowa Code § 537.2509, that consumers have a right to "prepay in full the unpaid balance of a consumer credit transaction, other than a consumer lease or a consumer rental purchase agreement, at any time." The ICCC also makes explicit allowances in Iowa Code § 537.2510(1) for rebates of unearned interest to consumers in the event of prepayment and includes a clear de minimis exception that relieves the creditor's rebate obligations when the rebate that would otherwise be required amounts to less than one dollar.

The provision for rebate on prepayment specifically refers to “prepayment in full of a precomputed consumer credit transaction” and makes no explicit allowance for rebates on other credit transactions, such as prepaid simple interest arrangements. The de minimis exception outlined in § 537.2510(1) therefore applies unequivocally to prepayment overpayments on precomputed interest transactions and limits the de minimis exception for lenders to rebate amounts below \$1. Whether that de minimis provision applies with equal vigor to simple interest contracts is less clear.

The lack of overt provision for prepayment rebates on simple interest contracts likely stems from the distinction between simple interest and precomputed interest credit contracts. Iowa Code § 537.1301(1) defines simple interest contracts, called the “actuarial method,” as credit arrangements that allocate payments “between the amount financed and the finance charge, [wherein] a payment is applied first to the accumulated finance charge and any remainder is subtracted from, or any deficiency is added to, the unpaid balance of the amount financed.” A precomputed consumer credit transaction, on the other hand, is defined in Iowa Code § 537.1201(36) as a credit transaction, “other than a consumer lease or a consumer rental purchase agreement, in which the debt is a sum comprising the amount financed and the amount of the finance charge computed in advance.”

In essence, as defined by Iowa law, debtors who borrow under a simple interest contract accumulate finance charges periodically and in relation to the outstanding balance of their amount financed, whereas debtors who enter into precomputed credit transactions agree to payments based on a finance charge fixed at the outset. Consequently, creditors who issue loans structured according to the simple interest method generally “earn” all interest owed to them and debtors who prepay such loans will only rarely overpay their lenders.

That said, under some circumstances, debtors who are prepaying pursuant to a simple interest contract may still overpay their lenders. Prepayment overpayment on a simple interest contracts may occur, for example, when a consumer purchases an insurance product, such as credit life insurance, for the life of a loan, and subsequently prepays the loan in full. Several factors indicate that the ICCC emphasizes a preference that lenders collect only earned interest and lead to the conclusion that the ICCC and its de minimis exception for rebates apply to prepayment overpayments on simple interest contracts, uncommon though they may be, in a manner similar to their application to precomputed interest contracts.

A close reading of what the ICCC includes in the definition of “finance charge” in conjunction with the list of exemptions indicates intent to encompass as many charges as possible. Iowa Code § 537.1301(21) defines a “finance charge” as any charge “payable directly or indirectly by the consumer and imposed directly or indirectly by the creditor as an incident to or as a condition of the extension of credit,” and § 537.2501 outlines a narrow list of “additional charges” that are excluded from the definition. By employing a broad definition of “finance charge,” the ICCC thereby restricts the range of charges that are not subject to rebate in the event of prepayment, suggesting a preference for earned rather than unearned finance charges regardless of the structure of the credit transaction. Returning to the example of credit life insurance, under these circumstances, the insurance premium constitutes a de facto component of the finance charge which must be earned.

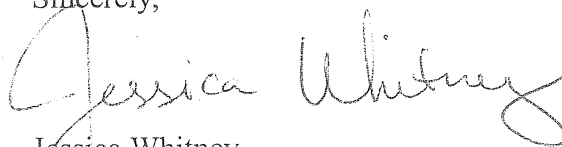
The ICCC further evinces its preference for earned finance charges and its commitment to consumer rebates by requiring rebates even if maturity is accelerated and a judgment is obtained against the debtor.<sup>1</sup> In addition, Iowa Code § 537.2510(3) defines the minimum charge creditors may collect regardless of prepayment, a limit that applies to all consumer credit transactions, “whether or not precomputed,” meaning it applies equally to simple interest transactions. The creditor must include the charge in the contract, and in no case may the minimum charge exceed \$7.50. Taking into account both the limitations on minimum finance charges for all credit transactions and the language limiting the under \$1 de minimis exception for rebates specifically to precomputed interest transactions leads to the conclusion that there is no de minimis exception for overpayment on simple interest contracts. The overall purposes of the ICCC, including “[p]rotect[ing] consumers against unfair practices” and “[p]ermit[ting] and encourag[ing] the development of fair and economically sound consumer credit practices,”<sup>2</sup> as well as the ICCC’s focus on lenders earning their finance charges, further support this conclusion.

Finally, in response to the question you raised about the possibility of establishing a de minimis rebate exception by addressing the issue in the contract, it should be noted that Iowa Code § 537.1107 explicitly states that “consumer[s] may not waive or agree to forego [their] rights or benefits under this Act.” The only exception is for consumers acting in the context of settling bona fide disputes.

In summary, these elements suggest that there is no de minimis exception within the ICCC for prepayment overpayment on simple interest contracts. In the unlikely event an Iowa consumer overpays when prepaying a loan pursuant to a simple interest contract, the consumer is entitled to a rebate of any unearned finance charges inadvertently paid to the lender, with the term “finance charge” having a broad definition in this context. Furthermore, lenders may not alter this obligation by including contractual language stipulating that rebates will not be given on overpayments below a certain threshold established in the contract.

Please note that this is an informal opinion of the Administrator; it is neither an official opinion of the Attorney General nor a formal ruling of the Administrator. It does not replace or provide legal advice. If you have any further questions, please contact me at the above phone number or address.

Sincerely,



Jessica Whitney  
Assistant Attorney General  
Deputy Administrator-Iowa Consumer Credit Code

cc: Rod Reed  
Iowa Division of Banking

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1 IOWA CODE ANN. § 357.2510(6) (West 2011); Lloyd’s Plan, Inc. v. Brown, 268 N.W.2d 192 (Iowa 1978).

2 IOWA CODE ANN. § 357.1102 (West 2011).