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ATTORNEY GENERAL

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Department of Justice

CONSUMER PROTECTION DIVISION

March 31, 1989

Dear

In February you contacted our office requesting an Attorney General's opinion on the application of the Iowa Consumer Credit Code (ICCC) to federal student loan programs. Although our office does not have statutory authority to issue formal Attorney General Opinions to private parties (Iowa Code § 13.2(4) authorizes opinions only upon request by members of the general assembly or state officers), the Administrator of the ICCC can issue informal advisory letters to assist parties in interpreting the Consumer Credit Code. See: Iowa Code § 537.6104(1)(d) (1987) and 61 Iowa Admin. Code § 10.4. Please consider the following discussion as an informal opinion letter.

In your letter you indicate your client, an institution for higher education located in Iowa, has asked you to review loan documentation forms used for federal student financial aid programs. Your letter states that federal law now requires educational institutions to issue promissory notes for student loans that contain provisions for late fees and the recovery of collection costs should a borrower default. Section 16028 of the "Student Financial Assistance Amendments of 1985", codified at 20 U.S.C. § 1087dd(c)(1)(H), authorizes late charges up to 20% of the amount of the monthly payment. Section 16033 of the 1985 amendments provides for the reimbursement of reasonable collection costs "notwithstanding any provision of State law to the contrary." This section is codified at 20 U.S.C. § 1091a(b).

As you note, Section 537.2502(1) of the ICCC permits delinquency payments in precomputed credit transactions of one and one-half percent of the unpaid amount up to a maximum of five dollars. Late charges of up to 20% of the monthly payment would

generally exceed this maximum. Unless authorized by a specific provision of Iowa law, the ICCC does not permit debt collectors to charge debtors their collection fees. See: Section 537.7103(5)(c). In addition, Section 537.2507 provides that consumer credit agreements may not contain provisions authorizing payment by the consumer of the creditor's attorney's fees.

As you mention, your client is unable to comply with the conflicting provisions of the ICCC and the federal law applicable to federal student loan programs. You have asked our opinion on two issues: (A) "Whether federal law allowing late charges preempts the ICCC limitations on delinquency charges", and (B) "Whether the words 'collection costs' as used in the federal statute include attorney fees and thus preempts the ICCC prohibition on attorney fees". As discussed below, we agree with your analysis that the ICCC is preempted in these areas.

Late Charges

Section 1087dd of Title 20 (Education) sets forth various terms and conditions required by educational institutions in their loan agreements with student borrowers. Section 16028 of the "Student Financial Assistance Amendments of 1985" Act amended 20 U.S.C. § 1087dd(c)(1) to read:

(1) Any agreement between an institution and a student for a loan from a student loan fund assisted under this part - . . . (H) pursuant to regulations of the Secretary, shall provide for an assessment of a charge with respect to the loan for failure of the borrower to pay all or part of an installment when due, which shall include the expenses reasonably incurred in attempting collection of the loan to the extent permitted by the Secretary, except that no charge imposed under this subparagraph shall exceed 20 percent of the amount of the monthly payment of the borrower; . . .

Revisions adopted for the Perkins Loan Program (formerly the National Direct Student Loan Program), 34 C.F.R. Part 674, also provide for the collection of late charges for loans made on or after January 1, 1986. 52 Fed. Reg. 45,557 (November 30, 1987) (codified at 34 C.F.R. § 674.43(b)(2)).

Based upon this language, we believe that the limitations on default charges provided in Section 537.2502(1) of the ICCC are preempted by federal law. This preemption extends only to federal educational loans encompassed within the provisions of 20 U.S.C. § 1087cc. As there is no apparent federal intent to preempt the borrower protections found in Sections 537.2502(2)

and (3), institutions must still comply with those sections. Therefore under 537.2502(2) late charges can be imposed only after the installment payment is ten days late, and a late charge assessed only once on an installment no matter how long it remains in default. For the purpose of computing late charges under Section 537.2502(3), payments must be applied first to current installments owed and then to delinquent installments.

Please also note that authority to assess late charges is limited to those charges that are "reasonably incurred" in attempts to collect the late payment. Thirty four C.F.R. § 674.43(b)(3) states:

- (3) The institution shall determine the amount of the late charge imposed for loans described in paragraph (b)(2) of this section based on either --
 - (i) Actual costs incurred for actions required under this section to secure the required payment or information from the borrower; or
 - (ii) The average cost incurred for similar attempts to secure payments or information from other borrowers.

52 Fed. Reg. 45,557.

These provisions restrict late charges to the reimbursement of expenses actually incurred or incurred on average in the collection effort. In addition, late charges are limited by 20 U.S.C. § 1087dd(c)(1)(H) and 34 C.F.R. § 674.43(b)(4) to no more than 20% of the installment payment most recently due. The 20% cap does not permit institutions to routinely contract for late charges of 20% unless they can substantiate that these charges equal the actual costs incurred in collecting late payments. As with all lending terms, the promissory note should accurately detail to students how late charges would be assessed on the student loan. In addition, the institution should be able to document to the borrower the cost basis for these late charges. See: Commentary to 34 C.F.R. § 674 found in 52 Fed. Reg. 45,554 (November 30, 1987).

Collection Costs and Attorney Fees

Federal law provides clear evidence of federal intent to preempt state laws that prohibit or restrict debt collectors from recovering their costs from borrowers who default on their student loans. Twenty U.S.C. § 1091a(b) states:

Notwithstanding any provision of State law to the contrary -

(1) a borrower who has defaulted on a loan made under this subchapter shall be required to pay, in addition to other charges specified in this subchapter, reasonable collection costs; . . .

Commentary to 34 C.F.R. 674 provides that "By specifically preempting any State law to the contrary, this federal statutory authority displaces any State law that bars recovery from the debtor of collection costs in general." (emphasis in the original) 52 Fed. Reg. 45,553.

The general prohibition in the ICCC forbidding a debt collector to assess their collection fee against a debtor is therefore preempted by federal law. Federal preemption in this area only extends to federal educational loans encompassed by Subchapter IV ("Student Assistance") of Chapter 28 (Higher Education Resources and Student Assistance), 20 U.S.C. §§ 1070 -- 1099.

It is not as evident whether the statutes and regulations discussed above includes attorney's fees in the general provisions requiring the reimbursement of "collection costs." Twenty U.S.C. § 1087dd(c)(1)(H) includes "expenses reasonably incurred in attempting collection of the loan" but does not mention attorney's fees. As you note, the commentary to 34 C.F.R. 674 suggests that student loan agreements must contain provisions for attorneys fees: "The terms of the new note must include a general provision for payment of collection costs, as well as agreement to repay attorney fees incurred in collecting the loan." 52 Fed. Reg. 45,554. Thirty four C.F.R. § 674.45(e)(1) provides that institutions "shall assess against the borrower all reasonable costs incurred by the institution with regard to a loan obligation." (emphasis added) 52 Fed. Reg. 45,558.

However, the commentary also states:

"these regulations require the institutions to attempt to recover all collection costs, including attorney fees, from the debtor, to the full extent permitted under applicable Federal and State law." (emphasis added).

52 Fed. Reg. 45,554.

In describing the litigation efforts institutions must take when unable to compel voluntary payment from a student debtor, the regulations provide that the institution must assess the borrower "All litigation costs, including attorney's fees, court costs and other related costs, to the extent permitted under applicable law". 34 C.F.R. § 674.46(b)(1), 52 Fed. Reg. 45,558.

It appears, however, that the general purpose of these recent amendments to federal law is to encourage or require institutions to become more aggressive in pursuing late paying or defaulting student loan debtors. The changes in the Student Financial Assistance Amendments of 1985 Act, Subtitle B and C, demonstrate the intent to authorize institutions to collect the full amount of the "reasonable costs" associated with default. The Summary to 34 C.F.R. § 674 states that the regulations were being revised to "increase the effectiveness of current collection efforts . . ." 52 Fed. Reg. 45,552. This language, in conjunction with the use of the term "all collection costs" and the commentary found in 52 Fed. Reg. 45,554 regarding the imposition of attorney's fees ("The terms of the new note must include . . . agreement to repay attorney fees incurred in collecting the loan") demonstrate, we believe, the federal intent to include the reimbursement of attorney's fees within the ambit of the term "collection costs". The purposes behind these amendments, to discourage student default and improve the collection and reimbursement for defaulted student loans, would be furthered by this construction.

Accordingly, we agree with your interpretation that federal law preempts the prohibitions regarding attorney's fees found in Section 537.2507 of the ICCC. Institutions issuing federal student loans under the authority of Subchapter IV, Chapter 28 (20 U.S.C. §§ 1070 -- 1099) may contract with students for the reimbursement of attorney's fees incurred in the collection of defaulted accounts without liability under the Iowa Consumer Credit Code. As with all collection costs, attorney's fees must be "reasonable". 20 U.S.C. § 1091a(b)(2); 52 Fed. Reg. 45,558 (to be codified at 34 C.F.R. § 674.45(e)(1)). In addition, the promissory note provided by the institution should clearly indicate that attorney's fees may be collected against the borrower should the student's loan go into default.

In summary, the ICCC's limitations on late charges and prohibitions against collection costs and attorney's fees are preempted by federal law for institutions participating in the federal student loan programs provided in 20 U.S.C. §§ 1070 -- 1099. In drafting their loan documents, institutions should be careful, however, to distinguish between federal student loan sources described above, and other financial aid arrangements made outside the parameters of these federal programs. Absent similar preemptive language and intent, state or private student loan programs may not violate the ICCC by contracting with students for late charges in excess of Section 537.2502 or for collection costs and attorney fees.

I hope this letter is responsive to your inquiry. Please understand that this letter is merely the advice of the Administrator and not an opinion or official ruling by the Attorney General or the Administrator. I would also like to thank you for the information and analysis regarding these issues that you provided in your letter. Please do not hesitate to contact us if you have any questions.

Sincerely,

Richard L. Cleland
RICHARD L. CLELAND
Administrator
Iowa Consumer Credit Code