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## Department of Justice

August 20, 1997

**RE: ICCC Informal Advisory No. 85**  
a) Fair Debt Collection Practices Act;  
b) Loan Documentation Fees

Dear

Thank you for your letter inquiring about H.F. 308, amending the Iowa Debt Collection Practices Act (IDCPA), and about loan documentation fees. The questions will be addressed in that order.

### **H.F. 308 -- IOWA DEBT COLLECTION PRACTICES ACT**

You ask about the applicability of H.F. 308 to notices of overdrafts and to notices on consumer loans.

First, it is important to note that H.F. 308 does not enlarge the category of transactions to which the notice requirement applies, nor did it impose any new requirement with regard to written notices that did not exist prior to its effective date. Thus if the notice requirement applies to overdraft advances or loan accounts, Iowa Code § 537.7103(4)(b) also applied to them prior to the passage of H.F. 308.

The Iowa amendment was drafted to track a 1996 amendment to the federal Fair Debt Collection Practices Act (FDCPA) which, in fact, lessened notice requirements.<sup>1</sup> Prior to the 1996 amendment, the federal notice was required to be on *all* communications,

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<sup>1</sup> Pub. L. 104-208 § 2305 (Sept. 30, 1996), amending the federal Fair Debt Collection Practices Act, 15 U.S.C. § 1692e(11).

written and oral.<sup>2</sup> The intent and effect of the new amendment to the federal act is to require the notice only with respect to the initial communication. If the initial communication is oral, an oral notice is required, and the first written communication also requires the notice. But the warning is no longer required on subsequent collection communications. The amendment also statutorily eliminated the required notice on court pleadings.<sup>3</sup>

In drafting the Iowa amendment to track the federal language, the sponsors added language providing that where the initial communication is oral, an oral notice must be given, to be followed by written notice only on the first written communication. Prior to H.F. 308, the Iowa notice requirement applied only to written communications, but it was required on all written communications, not just the initial one.

**Content of the Notice:** With respect to the content of the notice in connection with oral communications, it may be useful for you to know that the FTC has said that, so long as the collector clearly discloses he is seeking payment of a debt, "he need not state that all information will be used to collect a debt, since that should be apparent to the consumer."<sup>4</sup> However, the FTC Commentary to the FDCPA does not have binding force, and courts have disregarded it when they felt it conflicted with the plain meaning of the statute.<sup>5</sup> Hence the Commentary language may not provide a defense to a private suit on the issue, and some courts have held that both portions of the notice are required.<sup>6</sup>

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<sup>2</sup> "Communication" under the FDCPA is defined as "the conveying of information regarding a debt directly or indirectly to any person through any medium. 15 U.S.C. § 1692a(2). That definition includes oral, as well as written communication. See, e.g. FTC Commentary §§ 803(1)-1, 807(11)-1.

The federal act, of course, applies only to third party collectors, while the IDCPA applies both to third party collectors and to creditors collecting their own debts.

<sup>3</sup> Given the breadth of the definition of "communication" in the FDCPA, a dispute had arisen as to whether court documents were covered communications. The Supreme Court held that they were in *Heintz v. Jenkins*, 131 L.Ed.2d 395 (1995).

<sup>4</sup> FTC Commentary § 807(11)-2.

<sup>5</sup> See, e.g. *Heintz v. Jenkins*, supra.

<sup>6</sup> E.g. *Seabrook v. Onondago Bureau of Medical Economics*, 705 F. Supp. 81, 86 (E.D. N.Y. 1989).

The IDCPA also provides that the notice is not required where the disclosure would tend to embarrass the debtor. For example, when leaving a message with third parties, such a notice would not be appropriate, and well may violate other provisions of the IDCPA.<sup>7</sup>

### **I. Overdrafts**

Whether a bank's attempt to recoup funds advanced to cover an overdraft is subject to the notice requirement would appear to turn on the question of whether the advance constitutes a "debt" within the meaning of Iowa Code § 537.7102(3).

A covered debt is one which is a "consumer credit transaction," or would be if it were payable in installments, or a finance charge was imposed. Thus, if an overdraft transaction meets four of the five prongs of the definition of a "consumer loan," it would be subject to the IDCPA. Before it can be a "consumer loan," however, it must first constitute a "loan," as defined under the ICCC.

The ICCC defines a "loan" as any one of five types of debts or forbearance, of which the first would appear to apply to an overdraft situation.<sup>8</sup>

(1) The creation of a debt by the lender's<sup>9</sup> payment of or agreement to pay money to the debtor or to a third person for the account of the debtor....

A bank's advance of funds to cover an overdraft would seem to meet this statutory definition of "loan," as the bank created a debt<sup>10</sup> by paying money to a third person for the debtor's account.

"Loans" which are "consumer loans" subject to the IDCPA are those which

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<sup>7</sup> See Iowa Code § 537.7103(3).

<sup>8</sup> Iowa Code § 537.1301(25)(a).

<sup>9</sup> A "lender" is a person who makes a loan. Iowa Code § 537.1301(23).

<sup>10</sup> To avoid circularity, "debt" as used in this definition must be taken in its ordinary meaning. The Commentary to the definition of loan in the Uniform Consumer Credit Code describes this definition as continuing "the traditional concept of a loan as an advance of money..." Comment § 1-301(25) (1974 UCCC).

(1) are extended by a person regularly engaged in the business of making loans;

(2) are made to a natural person;

(3) are primarily for a personal, family, or household purpose; and

(5) do not exceed \$25,000.

Iowa Code § 537.1301(14)(a). (The fourth prong -- that the loan be subject to a finance charge or payable in installments -- is not required.)

Since banks regularly engage in the business of making loans, that element would typically be met, and the other three elements depend on the facts in a given case. Where those three variable factors are present, it would appear as though an overdraft advance would fall within the scope of the IDCPA. In those cases, the bank's initial notices of the overdraft should include the required notice, in accordance with Iowa Code § 537.7103(4)(b), as amended by H.F. 308.

## **II. Automated Notices on Consumer Loans**

Your letter also asks

1. Does the notice requirement apply to initial, automated late payment notices on consumer loans?

2. If so, would there be a problem if it were included on all notices, rather than just the initial ones?

As indicated by the prior discussion, a transaction which meets all but the fourth element of the definition of a consumer loan under Iowa Code § 537.1301(14)(a) is subject to the IDCPA, including the notice requirement.<sup>11</sup>

It would not present a problem to put the notice on communications subsequent to the initial ones, a practice which was in fact required under the provision prior to the amendment. The amendment was intended to ease compliance standards for debt collectors, not to increase consumer protection standards. If collectors find greater administrative ease in continuing to include it on all communications with the debtor, neither the letter nor the spirit of the law would be violated.

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<sup>11</sup> Presumably these transactions clearly meet one or more of the definitions of "loan" in Iowa Code § 537.1301(25)(a).

### LOAN DOCUMENTATION FEES

Your letter indicates that many banks are imposing loan documentation fees on all consumer loans, including non-real estate loans. They treat the charge as a prepaid finance charge, including it in the calculation of the APR, and providing a pro rata refund of the fee at prepayment.

As your letter acknowledges, loan documentation fees are not an authorized additional charge under Iowa Code § 537.2501.

Any fees imposed directly or indirectly by the bank, payable directly or indirectly by the consumer, incident to or a condition of the extension of credit are a finance charge. Iowa Code § 537.1301(19)(a). A loan documentation fee is a finance charge.

Our office would take no position on whether a bank, for its own internal accounting purposes, designates \$15 of its finance charge as a "loan document fee," so long as its doing so does not lead to a violation of the Code. The following provisions of the Code are the most likely to be implicated by the practice of designating a documentation fee.

\* It must be included in the calculation of the finance charge and the APR for disclosure purposes, which you indicate is the case.

\* It must be included in the calculation of the actual rate and finance charge for purposes of the contract terms and the applicable usury ceiling.

Your letter indicates that the fee is treated as a "pre-paid finance charge," subject to a pro-rata rebate at prepayment. You ask what our office's position is on this practice, and whether it is acceptable on either a pre-computed or simple interest loan.

While it is immaterial whether the creditor chooses to disclose it as a prepaid finance charge pursuant to Truth in Lending Regulation Z, § 226.18(c)(1)(iv),<sup>12</sup> the fee cannot be deemed to be "earned at consummation" for purposes of the ICCC, even if payment is deferred. This has both front-end and back-end implications for the creditor's computational practices.

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<sup>12</sup> That provision authorizes listing the prepaid finance charge in the itemization of the amount financed, though the figure cannot be included in the calculation of the amount financed. Cf. Reg. Z § 226.18(b)(3).

Initial Computational Issues: Because a loan documentation fee is a finance charge, and not an "authorized additional charge" under Iowa Code § 537.2501, it cannot be capitalized when determining the amount of interest which will be payable under the contract.

Iowa Code § 537.2401 provides for determining the maximum finance charge to be calculated "on the unpaid balance of the amount financed." Iowa Code § 537.1301(4) defines, in relevant part, the amount financed to be:

(b) In the case of a loan, the net amount paid to, receivable by, or paid or payable for the account of the debtor...plus additional charges if permitted under paragraph "c" of this subsection.

(c) In the case of a sale or loan, additional charges permitted under section 537.2501, to the extent that payment is deferred, that the charge is not otherwise included, [sic] in the amount permitted respectively in paragraph "a" or "b", and that the charge is authorized by and disclosed to the consumer as required by law.

The Comment to this definition in the Uniform Consumer Credit Code elaborates on this definition:

The term "amount financed" means the amount of credit extended to the consumer and includes not only the net price in sales and the net amount advanced in loans but also other amounts such as official fees, insurance charges, and other additional charges (Section 2.501) to the extent that payment is deferred. *An advance payment of finance charge...is deducted from the 'net amount paid' under paragraph (b) of this subsection...The term is a key definition...for it determines the amount on which the finance charge is imposed.* (Emphasis added.)

Consequently, no interest can be charged on any portion of the finance charge which the creditor designates as a loan documentation fee, even if payment is deferred. This would be the case irrespective of whether the transaction is interest-bearing or precomputed.

Rebate Issues: Your letter poses two questions concerning the rebate policies with respect to a loan documentation fee.

1. Use of a pro rata refund at prepayment:

Iowa Code § 537.2510(1) provides that, upon prepayment or

acceleration,<sup>13</sup> a rebate must be given to the consumer of "an amount not less" than the amount provided in subsection 2. Subsection 2, in turn, describes the actuarial method.

Since use of the pro rata formula does not result in a smaller refund to the consumer than would an actuarial calculation, it is an acceptable formula under the ICCA.

## 2. Rebates in interest bearing and precomputed transactions

This was the subject of an earlier Informal Advisory (# 71, Doland to Graf), a copy of which is attached. Obviously a fully precomputed transaction is subject to the rebate requirement under section 537.2501.

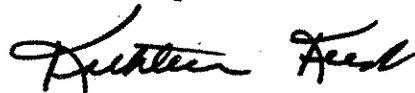
The question addressed in Informal Advisory No. 71 is whether a simple interest transaction "with a flat 'documentation' fee, treated and disclosed as a prepaid finance charge would be subject to rebate under Iowa Code section 537.2510."

As that letter indicates, the document fee is subject to rebate in an otherwise simple interest transaction, as well as in a fully precomputed transaction. It further notes that failure to do so may constitute a prohibited prepayment penalty, in violation of Iowa Code § 537.2509.

Please note that this is neither a ruling of the Iowa Consumer Credit Code Administrator, nor an opinion of the Attorney General.

If you have any questions, please do not hesitate to call.

Sincerely,



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Deputy Administrator, Iowa  
Consumer Credit Code

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<sup>13</sup> Iowa Code § 537.2510(6) requires that rebates be given upon acceleration as if payment had been made on the date maturity is accelerated.