Inf. Op. #89

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MEMORANDUM

TO: ***
CC: ***
FROM:
DATE: May 7, 1999
RE: Truth in Lending Rescission --
Accrual of Interest During Cooling-Off Period

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QUESTION

Does state law permit the accrual of interest during the cooling-off period provided by the federal Truth in Lending Act for non-purchase money home-secured loans?

SUMMARY RESPONSE

It appears that interest may accrue during the Truth in Lending rescission period provided that the funds are held in a bona fide escrow, not subject to the sole control and/or general use of the creditor.

ANALYSIS

Truth in Lending's Delay of Performance Rule

Under the federal Truth in Lending Act, and interpretative Regulation Z, consumers are given three business days to cancel or rescind a consumer credit transaction in which a non-acquisition money security interest (or automatic lien) is or may be taken in the consumers' primary dwelling.[1]

[1] 15 USC § 1635; Reg. Z, § 226.15 (open-end credit), § 226.23 (closed-end credit).

To avoid appearing to obligate consumers to the transaction prior to the expiration of the cooling-off period, creditors must delay performance "until the rescission period has expired and the creditor is reasonably satisfied that the consumer has not rescinded." Reg. Z, § 226.15(c) and 226.23(c).[2] That includes a delay in distributing advances or loan proceeds to the consumer (or third persons for the consumer). Official Staff Commentary §§ 226.15(c)-1, 226.23(c)-1. The creditor may disburse proceeds to a valid escrow during the rescission period, but the escrow may not be set up as an artifice to disguise premature disbursal.[3]

The Official Staff Commentary to Regulation Z, however, does state that the creditor may "accrue finance charges during the delay period" if that is permitted by state law. OSC §§ 226.15(c)-3, 226.23(c)-3.

The question, then, is whether Iowa law permits finance charges to accrue interest during the rescission period.

Iowa Statutes

ICCC-covered transactions:

Credit under $25,000 which is extended for personal, family or household purposes and is secured by a non-acquisition money security interest in the consumer's principal dwelling will be subject to the Iowa Consumer Credit Code. Iowa Code § 537.1301.[4]

The Iowa Consumer Credit Code provides that interest is to be calculated according to the actuarial method, on unpaid balances.[5]

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[2] Premature performance is sometimes referred to as "spiking." "Spiking" is derived from the premature performance of door-to-door home improvement contracts, where the work is begun prematurely in order to mislead consumers into thinking they cannot cancel once work has begun, or that they must at least pay for it, thus discouraging exercise of the cancellation right. Some people restrict use of the term "spiking" to the home improvement context; others use the term more broadly to refer to any violation of the delay of performance rules under cooling-off rules. For potential Truth in Lending consequences for violating the delay of performance rule, see generally National Consumer Law Center, *Truth in Lending* § 6.8.4 (3d ed. 1995 and Supp.).

[3] Official Staff Commentary §§ 226.15(c)-2, 226.23(c)-2. That provision notes that, for example, appointing the consumer as the trustee or escrow agent and distributing the funds to the consumer in that capacity during the rescission period would be an impermissible effort to evade the delay of performance requirement.

[4] If the amount financed exceeds $25,000, the transaction will be exempt, or if the debt is both a) secured by a first lien and b) incurred primarily for the purpose of acquiring real property, the transaction would be exempt from the ICCC. See Iowa Code § 537.1301(14).

[5] Iowa Code §§ 537.2201, 537.2401 (closed-end sales and loans). Interest on open-end transaction also is calculated on unpaid balances. Iowa Code §§ 537.2202, 527.2402 (open-end sales and loans).

Non-ICCC-covered transactions:

Transactions in excess of $25,000 for personal, family or household purposes secured by a consensual security interest or automatic lien on the consumer's primary dwelling will be subject to the interest provisions of Iowa Code § 535.2(a)(5).[6]

General Rules and Principles Construing Usury Statutes

It appears that there is no Iowa case law directly on point. Case law from other jurisdictions, however, interpret statutes with language parallel to the ICCC's "unpaid balances." Moreover, there is a body of general rules interpreting usury laws which addresses the accrual of interest on undistributed loan proceeds. See Annotation, *Leaving Part of Loan on Deposit With Lender As Usury,* 92 A.L.R.3d 769 (1979).[7]

The general rule appears to be that interest may begin to accrue when the funds are "disbursed" to the borrower.[8] The key to whether funds have been "disbursed" is control of the

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[6] This provision states the general rule regarding interest rates. Additional provisions regarding other types of finance charges and closing costs also apply; Iowa Code §§ 535.8, 535.10.

[7] One of the general interpretive rules is that minor delays in disbursement do not result in usury, in the absence of corrupt intent. *See* Id., § 7; 45 Am. Jur. 2d §§ 113, 181. However, this principle may simply be viewed as an example of the principle that "intent" is one of the elements necessary to establish a prima facie usury claim. *See generally* National Consumer Law Center, *The Cost of Credit: Regulation and Legal Challenges* §§ 10.3.1, 10.3.5 (1995 and supp.)

In the case of the TIL rescission period, the delay is a mandatory, scheduled delay, which has nothing to do with "fault" on either part, *cf.* Anno., supra. § 7(b) and (c). Consequently, the more apposite analogue would be the rule governing planned delayed disbursals. Not coincidentally, that rule has the advantage of being a fair, common-sensical rule.

[8] *See, e.g.* Collins v. Union Fed. S&L, 662 P.2d 610, 619 (Nev. 1983); Lyle v. Tri-County Federal Sav. & Loan, 363 A.2d 642, aff'd 371 A.2d 424 (Ct. App. Md. 1977)(interpreting statute with language parallel to ICCC's "unpaid balances"); Hoffman v. Key Fed. Sav. & Loan, 416 A.2d 1267 (Md. Ct. App. 1978).

Contra: Shelton v. Mutual Savings & Loan Assoc., 738 F.Supp. 1050 (E.D. Mich. 1990) (finding no relevant statute, or "common law" in federal law or Michigan on the question, and, in the absence of common law, found no prohibition on accruing interest during the period). NB: For purposes of this advisory, *Shelton* has not been considered persuasive for two reasons. First, the ICCC statute requiring that interest be applied to "unpaid balances" falls squarely within the analysis of the *Lyle* and *Hoffman* decisions which the *Shelton* court found inapposite. Second, the *Shelton* analysis misconstrues usury law generally. The charging of interest was prohibited at common law, so technically there is no "common law" which allows interest in the absence of a statute. Given the long tradition of usury laws, however, there has developed what could be termed a "common law" of principles for construing general usury statutes, which often do not have specific language. *See generally* National Consumer Law Center, *Cost of Credit: Regulation and Legal Challenges* § 9.3.1.1 (1995 and Supp.). The *Shelton* court did not review this body of general "common law" interpretive rules for usury statutes.

funds. The term may include delivering the proceeds into a *bona fide* escrow.[9]

In determining whether a particular escrow arrangement is considered *bona fide* and valid, both applicable TIL rules, and usury rules must be considered. As noted above, the escrow must not, under TIL rules, be a cover for premature disbursal to the consumer.[10] On the other hand, an escrow which is commingled with creditors' funds, or allows the creditor access to the funds for its purposes would likely be considered to remain under the creditor's control, and thus not be considered "disbursed."[11]

CONCLUSION

Reading Truth in Lending rules, Iowa state statutes, and general usury interpretive principles together, then, it appears possible to "disburse" funds into a valid, *bona fide* escrow if neither the lender nor the consumer have unrestricted control of and use of the funds during the escrow period. If funds are "disbursed" into a qualifying escrow during the rescission period, interest may accrue during that period.

This is not an official opinion of the Attorney General. For ICCC purposes, it may be considered an ICCC Informal Advisory, Iowa Code § 537.6104.

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[9] *See, e.g.* In re Bryant, 39 B.R. 313 (Bankr. Nev. 1984); Hoffman, *supra.*, 416 A.2d at 1275-1276; Lyle, *supra.*, 371 A.2d at 426. *See generally* Anno., *Leaving Part of Loan on Deposit with Lender As Usury*, § 11. *But cf.* Danziger v. San Jacinto Sav. Assoc, 732 S.W.2d 300 (Tex. 1987)(charging interest prior to disbursal from an escrow was usurious, despite there having been no apparent challenge to the *bona fides* of the escrow).

[10] See text accompanying note 3, above.

[11] See cases cited at note 9, *supra.*