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September 16, 1997

## DELAYED DEPOSIT SERVICES LICENSES

### INTERPRETATIVE BULLETIN #1

TO: CEO Addressed

RE: Iowa Code Sections 533D.10 (1-a) and 533D.10 (1-e)

Iowa Code Section 533D.10 (1-e) provides in essence that a licensee shall not repay, refinance, or otherwise consolidate a postdated check transaction with the proceeds of another postdated check transaction made by the same licensee.

In order to satisfy ourselves that licensees are in compliance with the foregoing provision, our office has implemented a policy of a one day delay between depositing or redeeming a check and the acceptance of a new postdated check with the same maker (i.e. check to be redeemed on deposited on Monday, a new postdated check may not be accepted until Tuesday).

Iowa Code Section 533D.10 (1-a) provides in essence that a licensee shall not hold from any one maker more than two checks at any one time.

In light of Section 533D.10 (1-a), our policy in regard to a one day delay is hereby modified to permit a licensee to accept a new postdated check on the same day another postdated check with the same maker has matured, provided the aggregate amount of the check maturing and the new check being written do not exceed the statutory loan ceiling of five hundred dollars.

Kindly review your operating procedures to ensure that you are in compliance with the provisions of this Interpretative Bulletin.

Sincerely,

Larry D. Kingery  
Bureau Chief



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March 16, 1999

**DELAYED DEPOSIT SERVICE LICENSEES  
INTERPRETIVE BULLETIN #2**

**To: Person in Charge**

**RE: Debt Collection - Threats of Criminal Prosecution**

At the end of 1998, customers of delayed deposit services companies brought certain collection letters to our attention. These letters state or imply that delayed deposit borrowers would be in violation of criminal statutes if they did not pay their debt.

We asked the Iowa Department of Justice for an opinion regarding this issue. Assistant Attorney General Kathleen E. Keest responded with "Informal Advisory # 87", a twenty-five page document. With this bulletin, we attach the four-page summary, "Informal Advisory # 87A - Summary." The full twenty-five page document, Informal Advisory # 87, is available from this office or the ICCA Administrator, Hoover Building, Des Moines, Iowa 50319.

Informal Advisory #87 shows that delayed deposit companies should not threaten criminal prosecution because:

- < Defaulted delayed deposit transactions would not be considered crimes in all but the most extraordinary circumstances.
- < Delayed deposit companies do not have the authority to file indictable criminal charges.
- < Delayed deposit companies violate Iowa Code Section 537.7103 by threatening criminal prosecution on defaulted transactions.

Based on the Advisory, we request that all collection practices involving the threat of criminal prosecution stop immediately. We will consider these practices a violation of Iowa Code Sections 537.7103 and 533D.9(2.d.).

Please review your operating procedures to ensure that your company's practices comply with the provisions of this Interpretive Bulletin.

Sincerely,

Rodney E. Reed  
Finance Bureau Chief

THOMAS J. MILLER  
ATTORNEY GENERAL



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## Department of Justice

February 18, 1999

Stuart W. McKee  
Assistant Finance Bureau Chief  
Iowa Division of Banking  
200 E. Grand Avenue, Suite 300  
Des Moines, Iowa 50309

**RE: Informal Advisory # 87A -- Summary**  
Deferred Deposit Loans, Chap. 533D  
Debt Collection -- Threats of Criminal Prosecution

Dear Mr. McKee:

You have asked four questions about the relationship of criminal bad check laws to the deferred deposit lending business, commonly called "payday loans," or "check loans."

With your inquiry, you forwarded two collection letters used by payday lenders in conjunction with NSF checks which invoke the specter of criminal prosecution as a consequence of non-payment of a check loan.

### SUMMARY

The questions arise as an outgrowth of a three year old statute which legalized the *business* of taking "cold" checks for deferred deposit in exchange for a fee, as a means of making small loans.

As is discussed in detail in the full version of this Advisory (Inf. Adv. # 87), these transactions are short-term, small-sum loans which are the subject of a special usury statute allowing extremely high interest rates. Because the check itself serves a dual function in these "check loans" or "payday loans" -- both as a substitute for the promissory note/credit contract/security agreement -- and, simultaneously, as a method of repaying the debt at a later time, *any* default on these loans will necessarily involve a bounced check.<sup>1</sup> It is this peculiarity of the "delayed deposit" lending business

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<sup>1</sup> Precisely because of potential complications as are presented by your questions, at least one state, when debating whether to legalize payday lending as an exception to its Industrial Loan Act, considered prohibiting the use of checks as "collateral" for these loans. Georgia failed to legalize payday lending as a business distinct from small loan lending, so the proposed prohibition on the use of checks became moot.

which demands special caution to assure that default on a small loan not be criminalized.

1. *Does the borrower's "bad check" in a payday loan represent a crime?*

While the Office of the ICCA Administrator is not vested with statutory authority to interpret Iowa Code § 714.1(6), the code provision making false drawing and uttering of a check (now referred to as "theft by check") a crime, it is necessary to examine how that provision would likely be applied to default on a payday loan to determine whether a payday lender's threats invoking the specter of criminal process violates the Iowa Debt Collection Practices Act, Iowa Code § 537.7103.

Given the way the payday loan, or "check loan" business operates, defaults on such loans will automatically involve a "bad check." Payday lenders have elected to go into the business of taking checks for which it is generally assumed that there are presently insufficient funds,<sup>2</sup> and they signify their understanding and willingness to accept such checks by charging a prepaid finance charge<sup>3</sup> to do so. We believe that, under the Iowa Supreme Court interpretation of Iowa's bad check and false pretenses laws, the courts would consider this to be a civil, contractual matter. The Court has indicated that prosecutors should not be cast in the role of collectors, and civil litigants should not be encouraged to use the criminal system to obtain restitution for breach of contract. Defaulted check loans are quintessentially the type of transaction to which this analysis would seem to apply in all but the most extraordinary circumstances, and perhaps to entirely all defaulted check loans. (See Inf. Adv. #87, Section III.)

2. *Can payday lenders seek criminal action against a borrower whose check bounces?*

First, only county attorneys have the authority to file indictable criminal charges for theft by check.<sup>4</sup>

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<sup>2</sup> As is discussed in Section I.B of the full version (Inf. Adv. #87), the effective interest rates for check loans are very high. Those familiar with the business, including the lenders, assume that, were there sufficient funds upon which to draw when the checks are written, the borrowers would do so, rather than paying triple-digit interest rates.

<sup>3</sup> A prepaid finance charge as used here means a finance charge that is considered earned at consummation, as distinguished from interest charged in reference to the time for which a loan is outstanding. Cf. Reg. Z, § 226.2(a)(23) (any finance charge paid separately in cash or by check before or at consummation of a transaction, *or withheld from the proceeds of the credit at any time.*) (emphasis added). As is discussed in Section I, Inf. Adv. #87, the fee in a payday loan is withheld from the loan proceeds. See generally National Consumer Law Center *Truth in Lending* § 3.8 (3d Ed. 1995 & Supp.)

<sup>4</sup> Checks under \$100 may be charged as simple misdemeanors, which may not be reviewed by the county attorney, as the "defendant" (debtors) may simply plead guilty at appearance. County attorneys are urged to discuss this potential problem with their law enforcement officers.

Even if default on a payday loan were to fall within the scope of the criminal code in any circumstance, at most a payday lender could ask a county attorney to evaluate the facts under the standards described in Inf. Adv. #87, Section III to determine whether there are sufficient grounds to warrant invoking public resources to pursue a default on a payday loan.

Second, it would appear that the legislature intended that the \$15 NSF penalty authorized in Chapter 533D be the exclusive penalty available for a defaulted payday loan. In that case, referral or threats of referral to public prosecutors for criminal prosecution would be prohibited, in all but the most extraordinary circumstances, if not entirely. (See Inf. Adv. #87, Section IV.)

*3. Does the criminal action represent a "legal action" that would require a notice of right to cure as required by the ICCC prior to the licensee taking such action?*

As discussed above, the criminal system should be involved in a defaulted payday loan in only the most extraordinary circumstances, if ever. However, if a payday lender seeks to involve the criminal system, a notice of right to cure under the ICCC is required prior to its making such a referral. (See Inf. Adv. #87, Section V.)

*4. Even if the answers to the above questions are yes, would the practice of threatening criminal prosecution [or implying a threat of criminal prosecution] violate Iowa Code § 537.7103 if the licensee never does seek to press criminal charges?*

In light of the answers to the earlier questions, we believe that threatening to invoke the criminal justice system to collect on payday loans is a violation of the Debt Collection Practices Act in any event.

However, any threat to invoke criminal sanctions to collect a debt is inherently coercive, and hence must be used with extreme caution to avoid abuse. Even if the courts were to determine that in some, extraordinary circumstances, prosecution in the context of a check loan default may be warranted, it would be impermissible under the Debt Collection Practices Act to threaten criminal consequences in most default situations, and it would never be permissible to do so when the lender does not make such referrals. (See Inf. Adv. #87, Section VI.)

As your questions demonstrate, a form of lending in which default can routinely be confused with criminality -- in the borrower's mind even if not in a prosecutor's mind -- requires special vigilance. It is worth noting that the industry itself recognizes that the use of checks as the note/collateral in these loans creates enormous potential for abuse because of the specter of criminal consequences. Industry representatives present at a recent meeting of credit regulators uniformly expressed the

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opinion that checks given in the payday loan context should not be the subject of criminal bad check laws.<sup>5</sup>

*For the complete legal analysis, please request Informal Advisory #87 (25 pages plus appendices) from ICCA Administrator, Hoover Building, Des Moines, Iowa 50319.*

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<sup>5</sup> Annual meeting of the National Association of Consumer Credit Administrators (NACCA), the association of state regulators under whose auspices payday lending occurs in states where it is permitted, or would occur if legalized. October 27, 1998 (San Diego, Ca.)