State of Washington
DEPARTMENT OF FINANCIAL INSTITUTIONS
DIVISION OF CREDIT UNIONS
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December 20, 2005

"A"

DCU Interpretive Letter No. I-05-12

RE: Payday Lending & Refunding Application Fee Deposits

Dear "A":

I have been asked by the Division of Credit Unions ("Division"), in my capacity as General Counsel for the Department of Financial Institutions ("DFI"), to interpret both federal and state law with respect to a policy of refunding application fee deposits in regard to the Payday Loan Program of a Credit Union or a Credit Union Service Organization ("CUSO").

1.0 Background

You recently asked the Division if a credit union could charge an *application fee* in addition to charging an interest rate on a short-term, unsecured loan.

As you know, the Division correctly replied "yes." The Division did, however, go on to advise you of an important detail of Truth in Lending Act ("TILA")[1] compliance.

Accordingly, you were previously advised correctly that a Credit Union should either (1) disclose the application fee as a "finance charge" for TILA purposes, or (2) always charge an application fee (without exception or waiver, even to employees) in order to make the application fee excludable from the calculation of "finance charge."

Now you have asked about the propriety of a policy of *refunding* application fee deposits to *approved* applicants of a payday loan. To properly answer this question, it will be helpful, in passing, to review your questions and the Division's answers regarding your other related inquiries made prior to this one.

2.0 Questions and Summary Answers

[1] Truth in Lending Act (P.L. 90-321), 15 U.S.C. 1601 et seq.

QUESTION: On certain short-term, unsecured loans, commonly known as "payday loans" ("Payday Loans"), may a Credit Union or a CUSO charge an *application fee*?

ANSWER: Yes. There is nothing in either federal[2] or state law[3] that, *by itself*, prohibits the charging of an application fee by a Credit Union or a CUSO on a Payday Loan or any other type of loan.

QUESTION: Must an *application fee* be included as part of the total amount of interest and charges permitted on a Payday Loan pursuant to the Check Cashers and Sellers Act, Chapter 31.45 RCW ("Act")?

ANSWER: Depends.

Credit Union as Originator. If a Credit Union is the originator of a Payday Loan, the Credit Union is exempt from the provisions of the Act.[4] In addition, pursuant to RCW 30.04.025 and RCW 30.22.040(12), a Credit Union may avail itself of the powers of a national bank under 12 U.S.C. 85,[5] which would permit the Credit Union to charge interest and fees in excess of the General Usury Statute, at RCW 19.52.020.[6] A CUSO would not violate the Act by merely facilitating or servicing such loans as an "agent" of the originating Credit Union, although a CUSO would have to be licensed under the Act.[7]

CUSO as Originator. If, however, a CUSO is the originator of a Payday Loan, it will be bound by the restrictions under the Act prescribing the maximum amount of fees and charges, *including* an application fee, which may be charged on a Payday Loan.

QUESTION: Must an application fee be included in the calculation of "finance charge" pursuant to the Truth in Lending Act ("TILA")?

ANSWER: Depends.

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[2] TILA, 15 USC 1601 et seq. There is a curious reference in the Official Staff Commentary to Regulation Z Part 4(c)(1) [12 CFR 226.4(c)(1)], to the effect that "[t]he creditor is free to impose the fee in only certain of its loan programs, such as mortgage loans." However, DFI has been unable derive any clarification of this sentence that would prevent an application fee being charged on a payday loan as a matter of law. Indeed, based upon a thorough review of Regulation Z and its Official Staff Commentary, we can find no prohibitions *under TILA* in the actual charging of an application fee. Of course, further amendment of Regulation Z could have an affect on our opinion expressed in this interpretive statement.

[3] Check Cashers and Check Sellers Act, Chapter 31.45 RCW.

[4] Pursuant to RCW 31.45.020, any "financial institution" authorized to do business in Washington, including a Credit Union, is itself exempt from the provisions of the Act.

[5] Pursuant to RCW 30.04.025 permits Credit Unions and other types of financial institutions enumerated in RCW 30.22.040(12) to take advantage of the so-called Most Favored Lender Doctrine available to national banks under 12 USC 85.

[6] For persons not otherwise exempt, the maximum rate of interest (including fees and charges) that may be imposed on a consumer borrower in Washington State is stated in a formula set forth in RCW 19.52.020. Currently, the maximum rate of interest on a consumer loan, not otherwise exempt, is 12% per annum.

[7] Pursuant to RCW 131.45.079, non-originating "agents" of payday lenders exempt under the Act, are themselves required to be licensed.

An application fee is not a "finance charge" pursuant to TILA and its requirements for calculating and disclosing an annual percentage rate ("APR"), provided that such application fee is charged on *all* loans made under a given loan program.

If a Credit Union or CUSO charges an application fee, or holds itself out that it will do so, and it desires to *not* disclose such application fee as a finance charge, then the Credit Union or CUSO may not waive the application fee with any application for a Payday Loan, even an employee. If, on the other hand, even *one* application fee is waived, then every application made under the Payday Loan Program must disclose the application fee as a "finance charge" pursuant to the requirements of TILA.

See Discussion at Subsection 3.2 below.

QUESTION: If a Credit Union or CUSO, acting as an originator, *refunded* an application fee deposit to all *approved* applicants who receive a Payday Loan, would the Credit Union or CUSO still have to disclose the application fee as a "finance charge" pursuant to all applicable advertising and disclosure requirements under TILA?

ANSWER: Yes. A *refund* of an application fee deposit is, for purposes of TILA, no different than a *waiver* of the application fee. Therefore, if a Credit Union or CUSO has such a lending policy, then:

- All APR disclosures in advertising should include the application fee deposit as part of "finance charge" pursuant to TILA;
- All Payday Loan applications should indicate that an application fee deposit is required and that it will only be refunded (i.e., waived) if the applicant is approved and the loan is funded;
- For all denied applications, the Disclosure Statements, as required by TILA, should calculate APR by including the *non*-refundable application deposit as part of the "finance charge"; and
- The Credit Union or CUSO must have well-documented lending policies for regulatory examination purposes, which indicate a practice of refunding (i.e., waiving) application fees for approved applicants who actually receive Payday Loans.

See Discussion at Subsection 3.3 below.

3.0 Discussion and Legal Analysis

3.1 TILA and the Act Have Different Purposes. It is important to distinguish between TILA and the Act for purposes of answering your questions. Each of these laws has a different purpose.

The U.S. Congress enacted TILA, and authorized the Federal Reserve to adopt and implement the companion Regulation Z,[8] so as to provide the public with a uniform system of advertising and disclosure of the true cost of consumer lending. Neither TILA nor Regulation Z sets actual limits on fees and charges *per se*.[9]

On the other hand, the Payday Loan provisions of the Act were enacted by the Washington State Legislature to set real limits on the total amount of fees and charges that can be made on a Payday Loan, in consideration of Payday Lenders being exempt from the General Usury Statute at RCW 19.52.020. While the Act exempts from these limitations and licensure financial institutions such as Credit Unions, the Act requires a CUSO, *either* as an originator or as a mere "agent" for an originating Credit Union, to be licensed under the Act. As a loan originator, a CUSO would be bound, as well, by the limits placed upon the total amount of fees and charges that can be made on a Payday Loan.

Neither TILA nor the Act modifies the other. A Credit Union might be totally exempt from the provisions of the Act, while a CUSO never is. TILA, apart from any provisions of the Act, is applicable and enforceable in *every* Payday Loan transaction.

3.2 Refund of Application Fee Deposits. TILA, at 15 USC 1605(a), declares:

> "Except as otherwise provided in this section, the amount of the ***finance charge*** in connection with any consumer credit transaction shall be determined as ***the sum of all charges, payable directly or indirectly by the person to whom the credit is extended, and imposed directly or indirectly by the creditor as an incident to the extension of credit.***"

[Emphasis added.]

TILA, at 15 USC 1604, empowered the Federal Reserve Board to adopt a uniform system of rules to implement TILA, known as Regulation Z.[10]

Regulation Z, at 12 CFR 226.4, further refines the definition of "finance charge," in relevant part, as follows:

> "(a) Definition. The finance charge is the cost of consumer credit as a dollar amount. ***It includes any charge payable directly or indirectly by the consumer and imposed directly or indirectly by the creditor as an incident to or a condition of the extension of credit.*** . . . .
> . . .

[8] TILA, at 15 USC 1604.

[9] Note Congressional intent in TILA, at 15 USC 1601.

[10] Federal Reserve Board Regulation Z, 12 CFR Part 226.

> (b) Example of finance charge. The finance charge includes the following types of charges, except for charges specifically excluded by paragraphs (c) through (e) of this section:
> . . .
> (c) Charges excluded from the finance charge. The following charges are not finance charges:
> (1) ***Application fees charged to all applicants for credit, whether or not credit is actually extended***. . . ."

The Official Staff Commentary interpreting 12 CFR 226.4 [Regulation Z Part 4(c)(1)] declares, in relevant part, as follows:

> Paragraph 4(c)(1).
>
> 1. Application fees. An application fee that is excluded from the finance charge is a charge to recover the costs associated with processing applications for credit. The fee may cover the costs of services such as credit reports, credit investigations, and appraisals. The creditor is free to impose the fee in only certain of its loan programs, such as mortgage loans. ***However, if the fee is to be excluded from the finance charge under §226.4(c)(1), it must be charged to all applicants, not just to applicants who are approved or who actually receive credit.***

[Emphasis added.]

Based upon the statute, the regulation and the official staff commentary above, an application fee is not a "finance charge" pursuant to TILA and its requirements for calculating and disclosing an annual percentage rate ("APR"), *only if* such application fee is charged on *all* loans made under a given loan program. If a Credit Union or CUSO charges an application fee, or holds itself out that it will do so, and it desires to *not* disclose such application fee as a finance charge, then the Credit Union or CUSO may not waive the application fee with any application for a Payday Loan, even an employee. If, on the other hand, even *one* application fee is waived, then every application made under the Payday Loan Program must disclose the application fee as a "finance charge" pursuant to the requirements of TILA.

What about a so-called "refund" of an application fee *deposit*? In our opinion, consistent with the statute, regulation and official staff commentary, if a Credit Union or CUSO *refunded* an application fee deposit to all *approved* applicants who receive a Payday Loan, the Credit Union or CUSO would still have to disclose the application fee as a "finance charge" pursuant to all applicable advertising and disclosure requirements under TILA. A *refund* of an application fee deposit is, for purposes of TILA, no different than a *waiver* of the application fee.

3.3 Implementing a Policy of Refunding Application Fee Deposits.

Therefore, a policy of refunding application fee deposits to approved applicants, consistently with other relevant provisions of TILA and Regulation Z, ought to contain the following standards and safeguards:

3.3.1 APR Disclosures in Advertising. All APR disclosures in advertising should include the application fee deposit as part of "finance charge" pursuant to TILA.

3.3.2 Loan Application Fee Disclosures. All Payday Loan applications should indicate that an application fee deposit is required and that it will only be refunded (i.e., waived) if the applicant is approved and the loan is funded.

3.3.3 Regulation Z Disclosure Statements. For all denied applications, the Regulation Z Disclosure Statements, as required by TILA, should calculate APR by including the *non*-refundable application deposit as part of the "finance charge."

3.3.4 Written Lending Policies. The Credit Union or CUSO must have well-documented lending policies for regulatory examination purposes, which indicate a practice of refunding (i.e., waiving) application fees for approved applicants who actually receive Payday Loans.

4.0 Concluding Remarks

The above-stated general interpretation of TILA and the Act is of general application to all Credit Unions and CUSOs similarly situated. However, the conclusions reached here are limited to the facts. The Division and the DFI as a whole reserve the privilege and authority of reaching different conclusions with respect to other persons subject to the jurisdiction of TILA and the Act who may present materially different questions, facts or representations.

If you have any questions, please do not hesitate to call upon Linda K. Jekel, the Director of the Division of Credit Unions

Yours very truly,

WASHINGTON STATE DEPARTMENT
OF FINANCIAL SERVICES

By: Joseph M. Vincent
General Counsel