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ADMINISTRATOR'S OPINION

Re: Collateral under § 5-2-214—Alternate Charge Installment Loans

Question Presented

Section 5-2-214 of the Uniform Consumer Credit Code (“UCCC”), C.R.S. § 5-1-101, *et seq.*, describes the conditions under which a supervised lender can charge an alternative finance charge on installment loans up to \$1,000. One condition is that the lender shall not take collateral from a consumer as security for payment of such loans. § 5-2-214(7). This opinion addresses the application of this prohibition to post-dated checks, debit authorizations, and other up-front payment authorizations.

Brief Answer

C.R.S. § 5-2-214(7) prohibits the holding of post-dated checks as collateral. Upfront payment authorizations are strictly limited to regularly scheduled installment payments that are revocable by the borrower, and otherwise provide no enhanced remedies to the lender upon default.

Analysis

I. Legal Framework Regarding Security Interests

The UCCC states, “[u]nless displaced by the particular provisions of this code, the ‘Uniform Commercial Code’ ... supplement[s] the provisions of this code.” C.R.S. § 5-1-103. Article 9 of Colorado’s Uniform Commercial Code (“UCC”), C.R.S. § 4-9-101, *et seq.*, defines the circumstances under which a lender can obtain a security interest in collateral to secure a debt. Upon default, the security interest gives the lender specified rights of enforcement against the collateral. C.R.S. §§ 4-9-601 - 629.

The UCC defines “collateral” as “the property subject to a security interest or agricultural lien,” C.R.S. § 4-9-102(12),¹ and a “security interest,” as “an interest in personal property or fixtures that secures payment or performance of an obligation.”

¹ The UCC definition of “collateral” includes examples of types of collateral that are included within the definition. C.R.S. § 4-9-102(12).

C.R.S. § 4-1-201(35). In contrast, the UCCC does not provide a definition of either term. Therefore, we use these terms as defined in the UCC.

Further, when a lender obtains a security interest in a consumer credit transaction, the federal Truth in Lending Act requires disclosure of the security interest before credit is extended. 15 U.S.C. 1638(a)(9). An underlying purpose and policy of the UCCC is to conform the regulation of consumer credit transactions to the policies of the federal Truth in Lending Act. C.R.S. 5-1-102(2)(f). In accord, the UCCC obligates lenders to comply with the requirements of the federal Truth in Lending Act. C.R.S. § 5-3-101(3).

II. Application of C.R.S. § 5-2-214(7) to Up-Front Payment Authorizations

C.R.S. § 5-2-214(7) provides that supervised lenders “shall not take collateral from a consumer as security for payment for any loan made pursuant to this section.” C.R.S. § 5-2-214(7).

Under the UCC’s definitions, the prohibition on collateral in C.R.S. § 5-2-214(7) means that lenders are prohibited from accepting post-dated checks as payment from consumers, including post-dated checks that correspond to future regularly-scheduled installment payments. The lender’s possession of the post-dated check represents prohibited collateral under C.R.S. § 5-2-214(7) because, under Colorado law, the future date of the check does not prevent a lender from using the check to obtain payment from the consumer’s bank prior to the date of the check. C.R.S. § 4-4-401(a).²

An up-front payment authorization is permissible under C.R.S. § 5-2-214(7) only if it complies with the following conditions.

First, the authorization must merely facilitate payment pursuant to regularly scheduled installment schedule. The authorization therefore cannot permit the lender to use the authorization to make any debit from the consumer’s bank account upon the consumer’s failure to make a regularly scheduled installment payment. This prohibition includes, without limitation, any attempt by the lender to use the authorization to: (1) charge a delinquency charge provided for in C.R.S. § 5-2-203; (2) charge an attorney fee provided for in C.R.S. § 5-5-112; (3) charge a fee for the return or dishonor of a check or other instrument tendered as payment provided for in C.R.S. § 5-2-202(1)(e)(II); or (4) debit an amount based upon the claim that a consumer’s default has accelerated maturity of the unpaid balance of the loan.

² In accord, with respect to loans made pursuant to the Deferred Deposit Loan Act, C.R.S. § 5-3.1-101, *et seq.*, the General Assembly has recognized that a lender’s acceptance of “dated instruments” such as post-dated checks constitutes collateral that serves as security for a loan. *See* C.R.S. § 5-3.1-102(3)(a). The General Assembly has allowed the use of such dated instruments as security for Deferred Deposit Loan Act loans, in contrast to the complete prohibition against security contained in C.R.S. § 5-2-214(7).

Second, the payment authorization must be voluntary on the part of the consumer and thus immediately revocable upon the consumer's request. Thus, a written agreement containing the terms of a loan made under C.R.S. § 5-2-214 may authorize a lender to make debits from a consumer's bank account under two conditions. First, the authorization is limited to the periodic installments permitted by C.R.S. § 5-2-214(2). Second, the written loan agreement states that the consumer may revoke this authorization at any time.

III. Truth in Lending Act Disclosure of Security Interests

As stated above, the federal Truth in Lending Act ("TILA") provides that lenders must disclose a security interest to consumers before extending credit. 15 U.S.C. 1638(a)(9). Regulation Z, a federal regulation promulgated pursuant to TILA, defines "security interest" as "an interest in property that secures performance of a consumer credit obligation and that is recognized by state or federal law." 12 C.F.R. § 226.2(25).

Courts applying TILA have held that a lender's acceptance of a post-dated check is properly disclosed under TILA as security for a loan. *E.g. Smith v. Cash Store Mgmt., Inc.*, 195 F.3d 325, 331 (7th Cir. 1999) ("We are therefore satisfied that Cash Store could lawfully assert under TILA that Smith's post-dated check was security for the loan").

Courts have similarly held that a lender's authorization to debit a consumer checking account, which is not merely a mechanism to facilitate payment, must be disclosed as a security interest under TILA. *E.g. Randle v. AmeriCash Loans, LLC.*, 932 N.E.2d 1200, 1207 (Ill. App. 2010).

This authority interpreting TILA's disclosure requirements supports the conclusions, set forth above, regarding the application of C.R.S. § 5-2-214(7) to up-front payment authorizations.

Conclusion

Post-dated checks are a form of security and may not be held as collateral by a supervised lender that makes loans pursuant to C.R.S. § 5-2-214(7). Such lenders may only obtain up-front payment authorizations from consumers for regularly scheduled payments and not for payment of the loan in full upon default.