STATE OF TEXA

OFFICE OF CONSUMER CREDIT COMMISSIONEF

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September 30, 1981 No. 81-22

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Dear Mr. Swift:

This is in response to your letter of June 12, 1981 in which you request our interpretation of several questions concerning recently enacted H.B. 1228. Because of the various questions you posed, I have decided to set out your questions in the order presented with my responses thereto directly following each question. All statutory references are to various provisions of Article 5069, V.T.C.S.

Your questions followed by my responses are as follows:

Question:

"1. Is the 'indicated rate' index available for open-end credit card plans which maintain a fixed interest rate?"

Response to Question 1:

When this question was first mentioned soon after the enactment of H.B. 1228, my immediate response was negative -- otherwise, one of the primary objectives of this legislation could be avoided. That objective was, of course, to provide that on open-end accounts the rate of interest as to new transactions over an extended period of time would reflect to some extent the then prevailing cost of money. I was and still am convinced that it was not the intent of the authors of H.B. 1228 nor the Legislature as a whole to provide that the interest rate or time price differential equivalent on an "open-end account" could be "locked in" forever at 24%.

Those who would advance the "lock in" the high rate approach on "open-end accounts" point out that Art. 1.04(a) provides that the parties to any written contract may agree to the indicated rate ceiling, and reason that this allows the parties to an "open-end account" agreement to agree that the indicated rate applicable this week is applicable to credit transactions made not only this week but all new loans or new purchases made in subsequent months or years. They also point out that Art. 1.04(h)(1) provides that as an alternative to the indicated rate ceiling the parties to an "open-end account" may agree to use the quarterly or annualized ceiling, and that the same section allows the creditor to implement the quarterly and annualized ceiling of three and twelve months respectively, but makes no mention as to how long the indicated rate may be implemented.

The reason for the quarterly and annualized rates being made available for use in open-end agreements was primarily because of a concern that it would be difficult for retailers and bank credit card issuers and their customers if the rates on their accounts had to adjust more often than quarterly and probably that creditors and customers alike would not want to adjust more often than annually, and certainly not on a weekly basis. So, in order that such credit grantors would not have to worry about weekly fluctuations in the indicated rate ceiling on "open-end accounts" on fixed rate contracts, Art. 1.04(h)(1) was designed to allow them to implement one rate for a period of either three or twelve months no matter what happened to the indicated rate ceiling during the elected period. The legislative history indicates that the Legislature assumed this to be necessary since it was felt that all new transactions on open-end accounts would be new loans or new extensions of credit for purchases, and if the indicated rate ceiling were applicable to new loans, the rate would change weekly and become unmanageable in "open-end accounts."[1] This Office has always viewed various transactions made pursuant to, for example, a Chapter 15 revolving loan account as separate loans. For example, Art. 15.01(k) defines a "Revolving loan account" as an arrangement between a creditor and a customer establishing an open-end line of credit under which (1) the customer <u>may obtain loans</u> from the creditor. The same type language also is used in Art.

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1 Transcript of Committee Hearing of House Financial Institutions Committee on H.B. 1228, March 3, 1981, Statements made by Rep. Bill Messer, House Sponsor of H.B. 1228, pages 6 and 7 of the transcript.

Transcript of House Floor Debate on H.B. 1228, March 23, 1981, pages 72-76, debate involving Rep. Bill Messer and Rep. Frank Collazo.

Transcript of House Floor Debate on H.B. 1228, March 23, 1981, pages 92-93, debate involving Rep. Bill Messer and Rep. Craig Washington.

Transcript of Senate Economic Development Hearing on H.B. 1228, April 13, 1981, page 6, Statements made by Senator Grant Jones, Senate sponsor of H.B. 1228.

Transcript of Senate Floor Debate on H.B. 1228, April 15, 1981, pages 5, 9, 10, and 11, Statements made by Senator Grant Jones.

15.01(1) in the definition of "Revolving triparty account." We have always felt until the transaction was entered into (use of card) on a Chapter 15 agreement that no loan had been made. Since no loan is made on a typical bank credit card agreement until the card is used, it is at that time that the parties become obligated for the rate of interest applicable to the transaction. As stated in 50 Am. Jur. 2d, Letters of Credit, §39-429:

> "The issuance of a credit card is but an offer to extend a line of open-end credit. It is unilateral and supported by no consideration. The offer may be withdrawn at any time, without prior notice, for any reason or, indeed, for no reason at all, and its withdrawal breaches no duty--for there is no duty to continue it--and violates no rights."

It is our position that the indicated rate ceiling may be utilized in an "open-end account" agreement subject to Art. 1.04(h)(1). There is no authority in Art. 1.04 which authorizes the extension of the indicated rate ceiling for more than one week as there is for the quarterly or annualized ceiling. Since each new transaction made pursuant to a typical open-end agreement is a new loan (charge) and it is not until the new transaction is made that the parties become obligated for the new loan (charge) as to that transaction within the meaning of Art. 1.04(a)(1), if the indicated rate ceiling is applicable to loans (charges) made pursuant to the agreement, it is the indicated rate ceiling for the week during which the new loan (charge) is made which is applicable to that loan (charge).

I would also point out that I believe this view is supported by the language of Art. 1.04(j) which provides that a creditor who implements the quarterly or annualized ceiling as to a majority of its open-end accounts under a particular plan may also implement that ceiling for all new customers who are brought into the plan during the period elected. Article 1.04(j) makes no mention of what happens to new customers in the event the creditor implements the indicated rate ceiling in such a plan. This omission indicates that the Legislature felt there was no need to mention the indicated rate ceiling in Art. 1.04(j) since the ceilings on both old and new customers would be subject to weekly changes. Also, this omission, coupled with the fact that under an "open-end account" program such as a bank credit card arrangement a loan is not made until such time as the offered credit is actually extended, seems to solidify the view that the Legislature did not intend that a creditor could choose to implement the indicated rate ceiling on an "open-end account" subject to Art. 1.04(h)(1) and "lock in" the highest possible rate forever. I might also add that there is a unanimous opinion among the many people with whom I have talked who were involved with H.B. 1228 during the legislative process that there was never any intent by anyone, including the sponsors and the credit grantors involved, that a creditor could implement the indicated rate ceiling on an "open-end account" subject to Art. 1.04(h)(1) and stay with it indefinitely, even though the ceiling came down. It would not seem logical to require, as does 1.04(h)(1), that the quarterly and annual ceilings be adjusted periodically but to allow a creditor to fix a rate forever on an open-end account based on the indicated rate ceiling. Thus, as previously stated, if a creditor elects to utilize the indicated rate ceiling in connection with a fixed rate open-end account subject to Art. 1.04(h)(1), the ceiling is subject to weekly adjustment. The various new loans or charges are subject to the ceiling applicable during the week in which such new loans or charges are made. A creditor may not select the indicated rate ceiling for one particular week and fix forever that ceiling rate on an open-end account subject to Art. 1.04(h)(1).

Question:

"2. Pursuant to Art. 1.04(h)(1), assume that the bank elects to implement (for all cardholders) the annualized index on September 1, 1981, and charge a fixed interest rate of 22% per annum on all extensions of credit made after September 1.

(a) When does the twelve month period for the annualized index begin running and when does it end? In my opinion it would begin September 1, 1981 and run through August 31 of the following year.

(b) When is the first day the bank is subject to a changed ceiling? In my opinion, the ceiling on September 1, 1981 (24% according to the annualized index) would continue through August 31, 1982, at which time the interest rate charged may be subject to an adjustment downward if, for example, the annualized ceiling was then 21%--but not beforehand regardless of the annualized ceiling on the interim "effective" dates.

(c) With regard to a new account established during the twelve month period (beginning September 1, 1981) will/can the new cardholder be subject to the same terms and conditions as accounts in existence on September 1, 1981? In other words, would the 'twelve month period' for an account opened on January 1, 1982, also come to a close on the same date as accounts in existence on September 1, 1981, with the interest rate then subject to modification?

(d) In notifying Bank Card customers of the conversion from Chapter 15 interest rates to Chapter 1 interest rates, and for purposes of the disclosure statement, is it permissible under subsection (h)(1) merely to state that the APR will fall somewhere between 18% and 24% without specifying the precise rate? (The exact rate, of course, would be disclosed in the billing statement mailed after the new rate went into effect.)

(1) If your answer to the above question is "Yes," would the same answer apply regardless of the annualized ceiling which was in effect on September 1, 1981? In other words, even if the annualized ceiling on September 1, 1981 was below the 24% cap, would the above disclosure be permissible?"

Response to Question 2:

(a) If the bank implements the annualized ceiling for all cardholders on September 1, 1981, and pursuant to Art. 1.04(h)(1) charges a fixed rate of 22%, the rate becomes applicable to all accounts on September 1, 1981 and continues in effect as to all accounts through August 31 of the following year. I am enclosing herewith a copy of our Letter Interpretation No. 81-18, dated September 1, 1981, which more fully explains our position on this question.

(b) I agree with your analysis expressed above concerning this question. The annualized ceiling may remain in effect for 12 months even though the "interim" annualized ceilings computed each quarter may be lower than the ceiling originally implemented.

(c) Article 1.04(j) provides that new accounts which are opened during the twelve-month period would be subject to the same ceilings as those in existence at the time the annualized ceiling was implemented on September 1, 1981. The new accounts would also be adjusted on September 1, 1982 even though such new accounts would not have been subject to the annualized rate for a full twelve months. Thereafter, of course, they would be subject to the implemented rate for the full period implemented.

(d) We are of the opinion that in implementing a fixed rate pursuant to Art. 1.04(h)(1) the customer must be advised of the precise annual percentage rate and that it is not sufficient to advise the customer that the rate will fall somewhere between 18% and 24%. In view of this response, I believe there is no need to comment on (d)(1).

Question:

> "3. Assume the same hypothetical posed in Question 2, and that the disclosure statement advises the customer that the annualized index may be renewed from time to time, and further that the ceiling at the end of twelve months was still at 24%. Could the bank raise the interest rate from 22% to 24% without any prior notification for the succeeding twelve month period?"

Response to Question 3:

In our opinion, when the creditor has implemented an annualized fixed rate at 22% subject to Art. 1.04(h)(1), the creditor may not raise the rate to 24% for the next twelve-month period without compliance with 1.04(i). The last sentence of Art. 1.04(h)(1) provides (paraphrase) that if the creditor elects to implement a rate greater than that previously agreed to, such creditor must comply with Art. 1.04(i).

Question:

"4. Assume the same hypothetical posed in Question 2, and also that the appropriate notice is provided pursuant to Art. 1.04(i) to a customer who maintained a Bank Card account on May 8, 1981.

(a) With regard to Art. 1A.01 of Chapter 1A, what is your interpretation of the phrase, "balance then existing"? Does this mean the balance on May 8, 1981, or any date arbitrarily chosen by the bank between May 8, 1981 and September 1, 1981 or the obligor's balance on the date the new rate is implemented, i.e. September 1, 1981?

(b) Assume the obligor had an outstanding balance of $100.00 on September 1, 1981, and obtained a $100.00 extension of credit under the Bank Card plan on September 15, 1981. The next periodic billing statement would reflect both the $100.00 previous balance and the $100.00 purchase. Assume the minimum payment for both balances was $10.00.

(1) The obligor makes a $20.00 payment prior to the due date. Can the $20.00 be applied wholly to the previous balance?

(2) The obligor makes a $100.00 payment prior to the due date. Can the total $100.00 payment be applied to the previous balance?

(3) The obligor makes a $150.00 payment prior to the due date. Can the previous balance be satisfied first with the remaining $50.00 applied to the new balance?

(a) If your answer to the preceding question is "Yes", what date can the bank first begin charging interest on the remaining $50.00 at the "new" interest rate?"

Response to Question 4:

(a) It is our opinion that Art. 1A.01 applies to balances existing on the date the new rate is implemented. Please refer to our Letter Interpretations No. 81-8, dated July 13, 1981, and No. 81-17, dated August 26, 1981.

(b)(1),(2),(3) & (3)(a). In our Letter Interpretation No. 81-12, dated July 30, 1981, I set out our general position on these questions as related to retail charge agreements subject to Chapter 6. Our basic approach is that the last sentence of Art. 1A.01 allows payments to first be applied to balances existing as of the date of implementation of the new rates. However, retail charge agreements, the subject of letter interpretation No. 81-12, are not subject to Art. 15.02(d), as the plan here in question would be if Art. 1.04 rates are implemented. As you know, Art. 15.02(d) requires a "free period" for purchases made pursuant to a plan subject to Chapter 15 if Art. 1.04 rates are implemented (see Letter Interpretation No. 81-2). We are of the opinion that as with Chapter 6 retail charge agreements, payments on an account subject to Chapter 15 may first be applied to "old" balances but consideration must also be given to Art. 15.02(d) if the creditor has implemented Art. 1.04 rates and Art. 15.02(d) therefore becomes applicable to the account. Therefore, in your question 4(b)(1), our position would be that the entire $20.00 payment may be applied to the previous balance. Likewise, in the 4(b)(2) situation we would say that the entire $100.00 payment could be applied to the previous balance. Also, in 4(b)(3) the previous balance of $100.00 could be satisfied with the $150.00 payment and $50.00 of the current purchases paid with the remaining $50.00 of the payment. Because of Art. 15.02(d), no interest could be accrued on the $50.00 of the current purchases which were paid. Interest could be charged on the $50.00 unpaid portion of the current purchases from the date of posting to the account. I might mention that Art. 15.02(d) is applicable only to purchases and not cash advances.

Question:

"5. Assume the same hypothetical posed in Question 2, that the appropriate notice was provided under Art. 1.04(i) and that Art. 1A.01 in Chapter 1A is observed. If the bank, at a later date, switches its system to, for example, a quarterly index, I understand that the notice under Art. 1.04(i) must again be provided. However, I do not believe Art. 1A.01 in Chapter 1A would apply. In other words, if the customer agreed to the modification, the bank could impose the new terms on current as well as future balances. Is this correct?"

Response to Question 5:

Article 1A.01 is applicable only to the initial implementation of Art. 1.04 provisions by a creditor. After such initial implementation, the creditor does not have to comply with Art. 1A.01, and any new terms may be made applicable to current as well as future balances (excepting any which might still be outstanding which were subject to 1A.01). As you noted, however, the creditor should comply with Art. 1.04(i).

Sincerely yours,

Sam Kelley

Sam Kelley
Consumer Credit Commissioner

Enclosures