STATE OF TEXAS

OFFICE OF CONSUMER CREDIT COMMISSIONER

SAM KELLEY, Commissioner

2601 NORTH LAMAR
AUSTIN, TEXAS 78705-4207

(512)479-1280
(214)263-2016
(713)461-4074

June 26, 1985   85-7

Mr. J. Scott Sheehan
Taylor, Hays, Price, McConn
and Pickering
Attorneys at Law
400 Citicorp Center
1200 Smith Street
Houston, Texas 77002

Dear Mr. Sheehan:

This is to acknowledge receipt of your letter dated May 23, 1985 in which you request an interpretation by this office of various provisions of Article 5069, V.T.C.S. as they may or may not be applicable to a proposed variable rate open-end credit program which would be offered by a bank. I will first summarize the essential elements of the program and then set out my responses to your questions.

Proposed variable rate open-end credit program.

Each account would be documented by a written credit agreement (with initial disclosure statement) and would establish an approved line of credit for $10,000. Subject to that limit, the borrower would obtain funds from time to time by drafting against a zero balance demand deposit account (no credit card is involved) tied into the credit account. The designated demand deposit account is used strictly to activate the credit line and is not the borrower's regular checking account. Billing cycles will be quarterly, the quarterly ceiling will be applicable to the accounts, and a statement of account will be issued at the close of each calendar quarter. The account agreement would require the borrower to make a minimum payment each calendar quarter equal to 10% of the new balance on the statement of account or $500, whichever is greater, within 25 days of the statement date. Any balance less than $500 would have to be paid in full.

The finance charge on the account would be computed using the average daily balance method and a daily periodic rate (based upon 1/365 or 1/366 as applicable). The account agreements would specify that Chapter 15 - Article 5069 is applicable to the accounts. The agreements would provide that the borrower would pay a finance charge at an annual percentage rate that varies based upon a margin percentage of 3% per annum above the rate quoted by the bank from time to time as its prime commercial rate (i.e., the basic agreed rate is prime plus 3% per annum).

Adjustments in the prime commercial rate, if any, would be made on the first banking day of each calendar quarter based upon the prime commercial rate in effect at the end of the preceding calendar quarter, i.e., adjustments due to changes in the prime commercial rate are only made once each billing cycle at the start of the cycle and will never exceed the quarterly ceiling. Adjustments will apply to current and future balances. Notice of adjustments in the prime commercial rate would be given in accordance with Article 1.04(h)(2).

The account agreements would specify that the bank could adjust the applicable margin percentage from time to time in its sole discretion by giving the borrower 15 days advance written notice with the proviso that any such adjustment would never exceed the agreed maximum margin percentage of 3% per annum. For example, the bank might elect to lower the margin percentage to 2%, or 1% or 0%, but later decide to increase the margin percentage back to 3%, but not higher. Any such adjustments would apply to current and future balances.

Typically, adjustments in the margin percentage would occur at some time after the account had been established. For example, the initial rate would be prime plus 3% per annum and at some later date the bank might give 15 days written notice that the margin percentage would be adjusted to, say, 2% per annum, with a resulting rate of prime plus 2% per annum. Later the same notice procedure would be used if the bank elected to increase the margin percentage back to 3% per annum. The 15 days advance written notice provision for margin adjustments would be designed to comply with Regulation Z, 12 C.F.R., Section 226.9(c).

In some cases, however, the bank might agree to make an initial margin adjustment when the account is opened. In those situations, the account agreements would still specify that the customers agree to pay interest at the rate of 3% per annum above the prime commercial rate. The agreement would further specify, however, that the margin percentage had been initially adjusted to, say, 2% per annum, and that the margin percentage would remain at that percentage until the bank gives 15 days advance written notice of a subsequent adjustment in the margin percentage. In giving Regulation Z disclosures regarding such an initial adjustment in the margin percentage the bank would furnish the "discounted variable-rate" disclosures contemplated by Official Staff Comment, Section 226.6, Section 6(a)(2)-10. Such Official Staff Commentary section essentially requires disclosures based upon the agreed rate (i.e., prime plus 3% per annum) and the initial discounted rate (i.e., prime plus 2% per annum).

First question and response thereto.

Your initial inquiry concerns the applicability of Article 5069 -1.04(g) to the proposed program. That section provides that "Unless otherwise agreed, when the parties have agreed to a rate, they are considered also to have agreed to any lesser rate that the creditor may elect, or is required under Section (h) of this Article to implement." It is the position of this office that Article 1.04(g) authorizes the bank, pursuant to the proposed program, to implement the feature whereby the customer agrees to a particular rate, i.e., a varying rate equal to the bank's prime commercial rate plus a margin percentage of 3%, and, so long as the bank never charges in excess of this agreed percentage, the bank may elect to charge any lesser rate from time to time (i.e., a margin percentage of 2%, 1% or 0%). The bank may also at some subsequent time after lowering the rate from 3% above prime to, say, 2% above prime, raise the rate back to 3% above prime. Our views concerning this procedure and Article 1.04(g) are more fully set out in our Letter Interpretation No. 83-2, February 10, 1983.

Second question and response thereto.

The proposed program states that the bank would give 15 days advance written notice of an adjustment in the margin percentage in order to be in compliance with Regulation Z, 12 C.F.R., Section 226.9(c). (Also refer to Official Staff Commentary, Section 226.9(c)-1; 6(a)(2)-2). The bank would not however be required to give the notices contemplated by either Article 5069 - 1.04(i) or Article 5069 - 15.05, V.T.C.S. It is our position that the proposed type of rate adjustment is not an amendment or revision as contemplated by Article 1.04(i) nor is such adjustment an amendment to the agreement as contemplated by Article 15.05. Since the customer would initially agree to all the possible rate adjustments (but never to exceed 3% above prime), such adjustments would not constitute an amendment or revision subject to one of those provisions.

Third question and response thereto.

You next ask whether the notice provisions of Article 5069 - 1.04(h)(2) would be applicable when an adjustment in the margin percentage occurs. Since the adjustments in the margin percentage would not be brought about by "operation of the index, formula, or provision of law", it is our opinion that the Article 1.04(h)(2) notice would not have to be given in connection with such adjustments. (See Letter Interpretation No. 83-2, February 10, 1983). However, if a change in the rate on the program were brought about by a change in the prime rate and not by an adjustment in the margin percentage, then the notice requirements of Article 1.04(h)(2) would be applicable. I would point out, however, that the second paragraph of Article 1.04(h)(2) was amended by Senate Bill 899 just enacted by the 69th Texas Legislature, which bill becomes effective August 26, 1985. Senate Bill 899 provides that the Article 1.04(h)(2) notice (set out in the second paragraph of that Article) does not have to be given prior to the billing cycle to which the rate change is effective if the open-end account is not subject to Article 1.11 or 15.02(d) of Article 5069, which the proposed program here discussed is not.

Sincerely,

Sam Kelley

Sam Kelley
Consumer Credit Commissioner