



STATE OF TEXAS

OFFICE OF CONSUMER CREDIT COMMISSIONER

SAM KELLEY, Commissioner

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December 30, 1981 No. 81-36

Mr. Dennis Swift
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Attorneys at Law
2600 Fort Worth National Bank Bldg.
Fort Worth, Texas 76102

Dear Mr. Swift:

This is to acknowledge receipt of your letter dated October 3, 1981, wherein you pose three questions concerning possible prepayment penalties on loans made pursuant to Chapter 4, Article 5069, V.T.C.S. A portion of your letter and your questions are quoted as follows:

"Please assume the following hypothetical situation. The bank makes an interest bearing, variable rate, installment (monthly) loan to a customer under Chapter 4. The interest rate is pegged internally to the bank's prime rate and the prime rate, in turn, is controlled by the quarterly index. Considerably prior to the loan's maturity, the customer decides to prepay in full. The note contains a provision that in the event of prepayment in full, the bank may assess a charge of two (2%) per cent of the outstanding principal balance. The 2% charge would be in addition to any interest which had accrued at the time of prepayment.

"1. Assuming a prepayment penalty in the above context is not construed as interest, is such proper under the provisions of Chapters 1 and 4?

"2. Assuming a prepayment penalty in the above context is construed as interest, is such proper under the provisions of Chapters 1 and 4?

"3. Is a prepayment penalty such as the one described above permitted on a Chapter 4 loan which is made on a precomputed (interest) basis?"

I would like first to respond to your questions as they relate to loans which are subject to the provisions of Chapter 4. If it is assumed that a prepayment penalty is not interest, it is the position of this Office that such a penalty may not be contracted for or charged on a loan subject to the provisions of Chapter 4, no matter whether the loan is interest bearing or precomputed. Art. 4.01(7) prohibits charges other than those specifically authorized by Chapter 4. Since it is here assumed that the prepayment penalty is not interest, there is no authorization in Chapter 4 permitting it to be charged.

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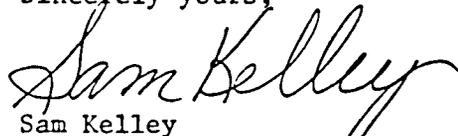
You also request our position on this question if a prepayment penalty is assumed to be interest. I do not see how a prepayment penalty which was considered to be interest could be assessed in a precomputed Chapter 4 loan since at the time the interest was computed and added to the amount advanced it would not be known whether the penalty would be charged, and obviously there would be no way to determine at the time of interest calculation an amount to be included which represented a possible prepayment penalty. We would conclude therefore that it would not be proper to have a prepayment penalty in a precomputed Chapter 4 loan no matter whether it was considered to be interest or considered not to be interest.

On the other hand, again assuming for the purpose of this response that a prepayment penalty would be considered interest, I am of the opinion that it would be permissible to have one in an interest bearing, variable rate loan subject to Chapter 4. However, since it is here assumed to be interest, the lender would have to ensure that the rate of interest resulting from its being assessed did not exceed the ceiling applicable to the contract.

It is our position that a prepayment penalty may be charged on an interest bearing, variable rate loan made pursuant to the provisions of Chapter 1 no matter whether such a penalty is considered to be interest or considered not to be interest. There is no prohibition against "other charges" in Chapter 1 similar to that found in Art. 4.01(7). Again, if it is assumed that such a charge would be interest, the lender would have to ensure that the resulting rate did not exceed the applicable ceiling. I might add that it is my impression that what case authority I have seen at this point indicates that Texas courts would hold that a bona fide reasonable prepayment penalty would not be interest.

Our response to your question with regard to a precomputed Chapter 1 loan would be the same as that given above relating to a precomputed Chapter 4 loan.

Sincerely yours,


Sam Kelley
Consumer Credit Commissioner