



STATE OF TEXAS

OFFICE OF CONSUMER CREDIT COMMISSIONER

SAM KELLEY, Commissioner

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June 30, 1981

No. 81-7

Mr. George A. Shannon, Jr.
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1980 S. Post Oak Rd., Suite 2200
Houston, Texas 77056

Dear Mr. Shannon:

This is to acknowledge receipt of your letter dated May 18, 1981 in which you request this Office to interpret several provisions of Article 5069, V.A.C.S., as recently amended by the 67th Legislature. I apologize for the delay in replying, but your letter raised several fundamental issues which I felt required a certain degree of study and consideration before I could adequately respond. I am also aware that the responses to your questions will affect not only your clients but a great many other people in this as well as other states.

I will not here set out verbatim your questions as presented in your letter but rather discuss our overall approach to the sections of the statute dealing with your questions and in such process attempt to provide you with answers to your specific inquiries.

Your first series of questions deals with variable rates as now authorized by Article 1.04 of Article 5069 and the appropriate time(s) for changing the variable rate ceilings. The opinions set out herein apply to both open-end and closed-end variable rate contracts except to the extent that an annual variable ceiling may not be used in a closed-end contract and the monthly variable ceiling may be used only in commercial transactions. It should also be noted that our opinions as to proper change-over dates of the various variable rate ceilings covered by 1.04(h)(2) are not applicable to open-end fixed rate contracts subject to 1.04(h)(1). Also, it should be remembered that variable rate ceilings are not permitted in connection with pre-computed add-on contracts (Article 1.04(f)), and that variable rate ceilings and the variable rates applicable to a particular contract or a group of contracts are not necessarily the same.

Article 1.04 authorizes four types of variable rate ceilings: (1) indicated rate ceiling, which I will call the weekly ceiling; (2) monthly ceiling, available only in commercial transactions; (3) quarterly ceiling; and (4) annual ceiling. You, as well as many others, have questioned as to what are the appropriate times or dates for the adjustment of these various ceilings.

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Article 1.04(f) provides as follows:

"The parties to any contract, including a contract for an open-end account, may agree to and stipulate for a rate or amount by contracting for any index, formula, or provision of law, by or under which the numerical rate or amount can from time to time be determined. However, the rate or amount so produced may not exceed the ceiling that may from time to time be in effect and applicable to the contract, for so long as debt is outstanding under the contract. Provided, further, that variable contract rates as described in this Section (f) are not allowed in a contract in which the interest or time price differential is precomputed and added into the amount of the contract at the time of the contract."

Article 1.04(a)(1), to paraphrase, provides that the weekly rate is based on twice the 26 week Treasury Bill rate for the week preceding the week in which the rate is contracted for. The statute of course does not state on which particular day of the week each new weekly ceiling shall become effective. However, the Treasury Bill auctions are customarily held each Monday (there are a few exceptions to this practice), and Monday is ordinarily the first business day of each week. We have been of the opinion that it is in keeping with both the language and the overall intent of the Act to say that Monday of each week is the proper day on which each new weekly ceiling becomes effective. We have taken this position since May 8, 1981, the effective date of H.B. 1228, which bill of course contained the new sections of Article 5069 relative to the variable ceilings. Accordingly, our weekly publications in the Texas Register have set out that the various weekly ceilings begin each Monday and extend through the following Sunday. As noted earlier, 1.04(f) provides that in a variable rate contract the rate or amount so produced may not exceed the ceiling in effect from time to time and applicable to that contract. If the parties have agreed that the rate applicable to a variable rate contract is the weekly ceiling or some other rate not to exceed the weekly ceiling, the ceiling on that contract should be reviewed each Monday to ensure that the ceiling for that week is appropriate. This means of course that such contracts consummated on some day other than a Monday will not have been in effect for 7 days prior to the ceiling change. In our view, this does not matter. In a variable rate contract based on the weekly ceiling entered into on a Thursday, for example, a new ceiling on that contract would become effective the following Monday.

The above general conclusions with regard to weekly ceilings would apply to monthly variable rate commercial contracts except of course the changes in ceilings would occur on the first calendar day of each month rather than on each Monday. I am aware that Article 1.04(c) provides that this Office shall compute the monthly ceilings on the first business day of each calendar month in which the rate applies. I believe that the use of "first business day" in this context is not controlling as to when the appropriate monthly rate becomes applicable. In fact, the remainder of the same sentence refers to "calendar month in which the rate applies." Also, the next sentence in 1.04(c) refers to the rate being "adjusted on a monthly basis." We have concluded, therefore, that monthly variable rate contract ceilings should be adjusted on the first calendar day of each month. Next August 1, 1981 falls on a Saturday and even though this Office is not required to calculate the

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August monthly rate until Monday, August 3, the August monthly ceiling becomes effective on Saturday, August 1. I might add that as a practical matter we always have the next monthly ceiling calculated the day after the last Treasury Bill auction in each month and will of course provide any interested party with this information upon request.

Article 1.04(d) sets out the four quarterly calendar dates on which this Office computes the quarterly and annual ceilings which are applicable for each of the respective succeeding calendar quarters beginning January 1, April 1, July 1, and October 1. Article 1.04(h)(2) requires that the quarterly ceiling shall be adjusted every three months and the annual ceiling be adjusted every 12 months. Since each quarterly ceiling is in effect for a calendar quarter beginning on one of the above-mentioned dates, and since 1.04(h)(2) requires quarterly ceilings on open-end accounts to be adjusted every three months, it is the position of this Office that the ceilings on a variable rate contract based on the quarterly average should be adjusted on each of the dates (January 1, April 1, July 1, and October 1) set out in the statute. It follows that contracts entered into during the middle of a quarter based on a quarterly variable ceiling will be subject to the initial applicable ceiling for something less than a three-month period. Even so, we are of the opinion that the ceilings on these contracts should be adjusted on the next and each of the subsequent (if applicable) calendar quarter dates set out in Article 1.04. We are of the opinion that the same procedure should be applied to closed-end variable rate contracts based on the quarterly ceiling (Article 1.04(d) and (f)).

Likewise, we are of the opinion that in a open-end variable rate contract based on the annualized ceiling, the ceiling is in effect for a 12-month calendar period and should be adjusted at the end of that 12-month period. For example, a open-end variable rate contract based on the annualized ceiling entered into during the months of July, August, or September is based upon the annualized ceiling computed as of June 1 and which became effective July 1. The contract itself may well not have existed for a full 12-month period prior to the time the ceiling on that contract is adjusted, but the ceiling itself will have been in existence for a 12-month period. We are of the opinion that 1.04(h)(2) requires that the ceiling applicable to the contract be adjusted 12 months after the ceiling itself came into existence, not necessarily 12 months after the origination of the contract. Thus, on these types of variable rate contracts the July 1 ceiling would be applicable to contracts made in July, August, and September and would be applicable to those contracts until the following July 1, at which time the ceiling would be adjusted. The October 1 ceiling would be applicable to these types of contracts made during October, November, and December and would remain in effect until the following October 1. Of course, the same procedure would apply with regard to the other two statutory calendar dates.

You also ask whether secondary mortgage loans made for personal, family, or household use may be made pursuant to the provisions of Article 1.04 and not be subject to the provisions of Chapter 5. We are of the opinion that such is possible in limited circumstances.

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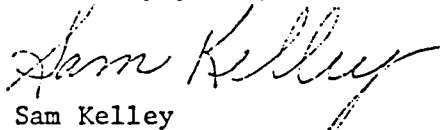
Article 1.04(n)(2) provides as follows:

"Any loan made under this Article that is extended primarily for personal, family, or household use but not for business, commercial, investment, agricultural, or other similar purposes, and that is payable in consecutive monthly installments and is described by Section (1), Article 5.01, of this Title and that is made by a person engaged in the business of making those types of loans, is subject to Chapter 5 of this Title, and any person except a bank or savings and loan association engaged in that business shall obtain a license under Chapter 3 of this Title."

As you can see, the purpose of 1.04(n)(2) was to ensure that the typical secondary mortgage loan previously covered by Chapter 5 would continue to be so covered, and that lenders would continue to be required to comply with the provisions of Chapter 5. One of the aspects of 1.04(n)(2) is that the secondary mortgage be repayable in consecutive monthly installments. Stated another way, if such a loan is not repayable in consecutive monthly installments, it can be argued that the transaction may be made pursuant to the rate provisions of Article 1.04 but is not subject to Chapter 5. As indicated earlier, I am of the opinion that in limited circumstances such a result is possible. In the example you propose, for instance, if the borrower asked for a secondary mortgage loan in the form of a 180-day note of prime plus 2% (assuming this did not exceed the applicable ceiling), I am of the opinion that the lender could avail itself of the Article 1.04 rates and not have to comply with the provisions of Chapter 5 since the loan is not repayable in consecutive monthly installments. On the other hand, if the lender simply structured a repayment schedule on a loan which would ordinarily have been a monthly repayment transaction in such a manner as to be only a "sham" in an attempt to avoid compliance with the provisions of Chapter 5, I would consider such a transaction to be subject to Chapter 5. For example, I have already heard several suggestions that the repayment schedule might be one payment every six weeks instead of monthly. I would consider a loan so structured to be a "sham" and still subject to the provisions of Chapter 5.

I hope this response is satisfactory, and if you have any further questions, please let me know.

Sincerely yours,



Sam Kelley
Consumer Credit Commissioner