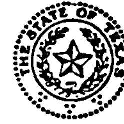

STATE OF TEXAS

OFFICE OF CONSUMER CREDIT COMMISSIONER

SAM KELLEY, Commissioner

1011 SAN JACINTO (512)475-2111
POST OFFICE BOX 2107 (214)263-2016
AUSTIN, TEXAS 78768 (713)461-4074

June 17, 1983 No. 83-5

Mr. Thomas G. Rundell, P.C.
Strasburger & Price
1200 One Main Place
Post Office Box 50100
Dallas, Texas 75250

Re: Senate Bill 405

Dear Mr. Rundell:

This is to acknowledge receipt of your letter dated June 10, 1983 in which you pose several questions concerning recently enacted Senate Bill 405 which will be codified as various sections of Art. 5069, V.T.C.S. The relevant portions of Senate Bill 405 will become effective July 1, 1983. All statutory references herein are to various provisions of Article 5069, V.T.C.S. Also, all the questions you presented in your letter relate to lender credit card agreements in which a bank is usually the credit card issuer. This response is limited to our interpretations of the applicable statutes as they relate to those type agreements only. Because of the comprehensive nature and length of the questions presented in your letter I will first quote the portion of your letter which sets out the fact situation to which your questions relate. I will then quote your questions in the order presented and will set out my response to each question immediately following each quoted question. The quoted fact situation from your letter is as follows:

"For purposes of responding to the following questions, please assume that the plan involved is the customary open end credit plan pursuant to which agreements ("cardholder agreements") a bank or other financial institution issues to individuals (the "cardholders") credit cards which will be used for personal, family or household purposes. The cardholder agreements are, by contract, governed by Chapter 4 and have implemented fixed interest rates under annualized ceilings as previously authorized by Article 1.04. In connection with transactions for accounts under the plan, the credit card issuing institution (the "issuer"), if it has agreements with merchants,

may receive a merchant discount should the cardholder acquire goods or services from a merchant which has a contract with the issuer. In some circumstances, however, the issuer will not have any contracts with any merchants, or, if the issuer has such contracts, the issuer's cardholder may have a transaction with a merchant which has not signed an agreement with the issuer. However, in the latter two circumstances, assume that the issuer, in connection with the cardholder's transaction, does receive a fee or other consideration from another financial institution which has a contract with the merchant from which the cardholder acquires the goods or services. The issuer intends to implement a rate permitted under Article 15.02(d), as amended by S.B. 405, as to all transactions occurring under such agreement after June 30, 1983.

Based on the foregoing, we would appreciate your advice with respect to the following questions:"

Question No. 1. "Does Section 32 of S.B. 405, which adds Article 1.11, apply to the cardholder agreements described above?"

Response to Question 1. Section 32 of S.B. 405, which is a new Article 1.11, does not apply to the cardholder agreements described above. Art. 1.11 is not applicable to open-end account credit agreements if a merchant discount as defined in Art. 1.01(h) (S.B. 405-29) is imposed or received by the creditor in connection with the credit card transactions. The definition of merchant discount in Art. 1.01(h) is very broad and includes any consideration whatsoever received by a creditor from any person other than the obligor. In the circumstances you describe the issuer would either be receiving a typical merchant discount from a merchant or some type of consideration from another financial institution, which consideration would fall within the definition of merchant discount in Article 1.01(h). For these reasons, it is the opinion of this Office that Art. 1.11 (Sec. 32 of S.B. 405) is not applicable to the fact situation set out in your letter.

Question No. 2. "As to a cardholder agreement which has implemented a rate permissible under the applicable annualized ceiling which is in excess of eighteen percent, does Section 37 of S.B. 405 apply so as to require that the interest rate imposed on transactions under such cardholder agreement occurring before July 1, 1983, be reduced to eighteen percent?"

Response to Question No. 2. My reply is "No." Section 37 of S.B. 405 does mandate that as of July 1, 1983 certain annualized ceilings will be deemed to be 18% per annum. However, this section of the bill is prospective in nature and does not apply to transactions occurring prior to July 1, 1983. The next to the last sentence of Section 37 states as follows:

> "Notwithstanding the foregoing, a credit card transaction occurring before the effective date of Sections 29 through 36 of this Act as to the account under which it is made is governed by the law in effect immediately before the amendments made by those sections, and that law is continued in effect for that purpose."

The purpose of the above set out language was to insure that transactions occurring before the effective date of Senate Bill 405 will continue to be governed by the law as it was when they were made. When the pre-July 1, 1983 or pre-July 1983 billing cycle closing date transactions were made they were subject to an annualized ceiling computed by using a formula based on twelve months of six month treasury bill auction rates. They will continue to be subject to that ceiling until paid. (Please see my response to your question No. 7). As a matter of fact that portion of Section 37 of Senate Bill 405 which mandates that certain annualized ceilings be deemed to be 18% as of the effective date of the Act would have no effect on lender credit card agreements since it does not apply to pre-effective date balances and as of its effective date Senate Bill 405 (Section 34) requires these types of agreements to be subject to a quarterly ceiling and quarterly adjustment.

I might add here that in our view the date the transaction occurs (card used) controls as to whether the transaction should be considered as a pre-Senate Bill 405 transaction. For example, assume that an issuer implements Senate Bill 405 as of the July, 1983 billing dates. A cardholder whose account is closed on July 14, 1983 makes a $100 transaction with a merchant on July 10, 1983 but the transaction is not posted to the cardholder's account until July 18, 1983. The transaction would be considered as occurring prior to the effective date of implementation of Senate Bill 405 for the purposes of Section 37 of Senate Bill 405. This does not alter our view that interest should not accrue on a transaction prior to date of posting.

Question No. 3. "Is Article 15.02(b) applicable if the issuer, subject to the limits of Article 15.02(d), as amended, charges a rate authorized by Article 1.04 so that the issuer may charge interest on the average daily balance of the accounts?"

Response to Question No. 3. It is our position that Art. 15.02(b) is applicable if the credit card issuer, within the limits as provided by Art. 15.02(d), is utilizing the rates authorized by Art. 1.04, and the interest charge may be computed on the average daily balance. Art. 15.02(b) was part of the original Chap. 15 enacted in 1979 and the rate authorized in 15.02(a) was the only rate available on a Chap. 15 agreement at that time. However, in both 1981 and 1983 the legislature authorized alternative rates to those in Art. 15.02(a) on a Chap. 15 agreement. It is our view that the

provisions of 15.02(b) are applicable to those alternative rates (15.02(e)) as well as those authorized in Art. 15.02(a). The rates in 15.02(a) will no longer be available to lender credit card agreements as of the effective date of Senate Bill 405 since such agreements must be subject to Art. 15.02(d) and the rates authorized by Art. 1.04. The provisions of Art. 15.02(b) will be applicable to such lender credit card agreement plans made pursuant to Art. 15.02(d).

Question No. 4. "With respect to Section 34 of S.B. 405 and differences between the October 1, 1983 effective quarterly ceiling (the "October Ceiling") and the July 1, 1983 effective quarterly ceiling (the "July Ceiling"):

(a) if the October Ceiling is less than the July Ceiling and maximum rate permitted under the cardholder agreement, must the issuer implement a rate not exceeding the October Ceiling on October 1 (and, if so, on balances existing on each account on such date or only on transactions occurring on and after such date) or may the issuer implement a rate not exceeding the October Ceiling effective with (and applying only to balances existing on and after) the first day of each cardholder's billing cycle which commences in October, 1983;

(b) if the October Ceiling is greater than the July Ceiling, may the issuer (assuming the issuer lawfully may do so under its cardholder agreements) implement a rate not exceeding the October Ceiling effective as to the average daily balance in the accounts as of the end of each billing cycle which closes in October, 1983?"

Response to Question No. 4. Sec. 34 of S.B. 405 provides that certain types of credit agreements must be subject to Art. 15.02(d), and that such agreements must be subject to quarterly adjustment ". . . which adjustment shall be made at the option of the creditor either on the quarterly calendar dates set out in Art. 1.04(d) of this Title or on the first day of the first billing cycle of an account immediately following said quarterly dates. . ." It is the position of this Office that the above quoted language from Section 34 of Senate Bill 405 allows the creditor an option with regard to cardholder agreements subject thereto (only those covered by the new Art. 15.02(d)). The creditor will be allowed to implement each new quarterly rate either on one of the four quarterly calendar dates set out in Art. 1.04(d) or beginning on the first day of each billing cycle immediately following each of said four quarterly calendar dates. The above quoted language was added to the bill by the House Financial Institutions Committee after the bill had passed the Senate (later concurred in by the Senate). Its purpose was to ensure that if the creditor so desired the rates could be implemented so as to coincide with billing cycle dates and

thus avoid the difficult problem of split billing cycles. Thus, in answer to your question 4(a), the creditor does not have to implement a rate not exceeding the October Ceiling on October 1. However, if the creditor desires to do so, the new rate (and ceiling) would be applicable to transactions occurring on or after such date for the remainder of that quarter, as well as to the balances existing on the account and prior to that date which balances had been incurred since the effective date of Senate Bill 405. It is our position that in the example given even though the issuer initially implemented the new quarterly ceiling on July 1, 1983, because of the option afforded by Art. 15.02(d) the issuer may adjust the ceiling the next and each succeeding quarter as of the billing cycle dates. As previously mentioned, balances incurred prior to the effective date of Senate Bill 405 are subject to the law as it existed at that time.

Our response to your question 4(b) is "No." If the October Ceiling (and rate) is greater than the July Ceiling (and rate), the creditor may not implement a rate as of the end of each billing cycle which closes in October since such an implementation would in effect retroactively apply to a portion of the cycle which was in the previous quarter when the ceiling was lower. However, the creditor may implement the new higher last quarter (October) ceiling beginning with the first day of an account's new billing cycle beginning in October and keep that ceiling in effect for three monthly billing cycles as to that account. This would mean that if the first day of such a monthly billing cycle is October 15, the ceiling applicable to that account will be in effect until Jan. 14, 1984. This may result in the rate on that account for the first fourteen (14) days of January being in excess of the quarterly ceiling applicable to January, but we are of the opinion that this is permissible because of Section 34 of Senate Bill 405. It is emphasized that this letter only discusses agreements subject to 15.02(d).

Question No. 5. "Does the answer to either question 4(a) or (b) vary depending on whether the issuer's cardholder agreements provide for a fixed rate or a variable rate program, and, if so, in what respect?"

Response to Question No. 5. No, our response given to Question 4(a)(b) applies to both fixed rate or variable rate programs which are subject to Article 15.02(d). Again, the conclusions set out in this and the previous response are limited to agreements subject to Art. 15.02(d). For our views on the standard procedure for adjustment of ceilings on contracts not subject to Art. 15.02(d) reference should be made to Letter Interpretation Numbers 81-7, June 30, 1981 (variable rate) and 81-18, Sept. 1, 1981 (fixed rate).

Question No. 6. "Since the cardholder agreements previously described have, by legislative action, been made subject to Chapter 15 and the quarterly ceiling (subject to the limits of Article 15.02(d)):

(a) is any notice regarding the applicability of Chapter 15 or the quarterly ceiling to the issuer's cardholders required to be sent prior to or during the billing cycles commencing in July, 1983;

(b) is any amendment of the cardholder agreements required at any time;

(c) if amendment of the cardholder agreements is required, may such amendments be accomplished through use of either Article 1.04(i) or Article 15.05?"

Response to Question No. 6. We have concluded that state law <u>does not</u> require notice of the applicability of Chapter 15 or the quarterly ceiling be sent to the issuer's cardholders prior to or during the billing cycles commencing in July, 1983. We are aware that Art. 1.04(i) provides for a notice procedure in the event of certain contractual revisions, and here the credit programs are being changed from an annual adjustment period to a quarterly adjustment period, and the statutory limits between which the ceiling (rate) may float will be changed. However, the changes mandated by Senate Bill 405 were of course directed by the Texas Legislature and not initiated by the creditor. In every instance here relevant the rates applicable to the agreements will be decreasing. The last sentence of Section 34 of Senate Bill 405 (new Art. 15.02(d)) states that notwithstanding any other provisions of law, a creditor charging a rate limited by Art. 15.02(d) shall not be required to disclose any decreases in the rate applicable to subject agreements. Additionally, Art. 1.04(g) states 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 to implement. Here, by a change in applicable law, the creditor has been required to implement a lesser rate. Because of the short time between enactment of Senate Bill 405 and July 1, 1983 it would have been virtually impossible to give any sort of meaningful notice to the millions of cardholders and in any event there would not seem to be any public policy which would be served if it were required that notice be given to a cardholder informing him/her that the interest charge on his/her account(s) would be decreased. For the reasons stated our answer to your Question 6(a) is "No."

However, in response to your Questions 6(b) and (c) it is our position that the issuer is required after the July 1, 1983 change to advise its cardholders of the changes in the plan(s). As mentioned, the ceiling applicable to the agreements has been changed from the annual to the quarterly, and if, after

the quarter beginning in July, 1983, the creditor wished to raise the rate on the agreements there would be no authority to do so (absent notice or agreement) since the increase in the rate would be based upon an increase in a ceiling to which the cardholder had not agreed nor of which notice had been given.

It is our position that the amendment procedure provided for in Art. 15.05 and Art. 1.04(i) are both available for agreements subject to Art. 15.02(d). However, as will be noted in our response to your Question Number 9, it would seem that the notice provisions of Art. 1.04(i) would usually be more appropriate and useful.

Question No. 7. "With respect to the balances in accounts under the above-described cardholder agreements existing on July 1, 1983, if the issuer may continue to charge interest at the rate presently in effect through the expiration of the annualized ceiling presently applicable, as to the unpaid portion of such balances existing when the presently-effective annualized ceiling expires, may the issuer charge interest at the rate presently in effect (subject to any reductions in the rates mandated by reductions in the annualized ceilings which would next have become effective as to such accounts but for the effect of Section 34 of S.B. 405) and, if so, on what basis will such subsequent annualized ceilings be calculated?"

Response to Question No. 7. As to balances in existence as of the July, 1983 effective date of S.B. 405 (excluding any balances still remaining which were "grandfathered" because of H.B. 1228 - effective May 8, 1981) the issuer may continue to charge interest on those balances at the rate presently in effect to the expiration date of the current annualized ceiling period. As mentioned in my response to your Question Number 2, the law in effect at the time they were incurred will still be applicable in the future to pre-Senate Bill 405 balances. When those pre-July 1, 1983 or pre-July, 1983 billing cycle closing date purchases were made they were subject to an annualized ceiling computed by using a formula based on twelve months of six month treasury bill auction rates. Even though beginning July 1, 1983, annualized ceilings for future purchases will be computed by utilizing three months of treasury bill auction rates, it is our position that as to transactions made prior to the effective date of the relevant provisions of S.B. 405 the annualized ceilings applicable to those transactions should be computed by using twelve months of treasury bill auction rates. This will of course mean that this Office will in the future compute and publish more than one type of annualized ceilings. One annualized ceiling based on twelve months of treasury bill averages will be applicable to pre-S.B. 405 balances. Therefore, at the end of the described issuer's annual contract period, the ceiling for the next annual period for those unpaid pre-S.B. 405 balances will be the annualized ceiling computed by using twelve months of treasury bill averages.

Question No. 8. "Does the requirement contained in Section 3 of S.B. 405 with respect to identification, in contracts of authorized lenders subject to regulation by your office, apply to cardholder agreements above-described under which the creditor is a bank, savings and loan association or credit union?"

Response to Question No. 8. It is our view that the portion of Section 3 of S.B. 405 which will be codified as Art. 2.02(4) does not apply when the creditor is a bank, savings and loan association or credit union. (Please see Letter Interpretation Number 83-4, June 8, 1983.)

Question No. 9. "If an issuer desired to amend its cardholder agreements to provide that the cardholder agreements will be governed by Chapter 15, that the rates are subject to the quarterly ceiling as specified in Article 15.02(d), and that the interest rate will be a fluctuating interest rate equal to the quarterly ceiling from time to time in effect but in no event more than twenty-two percent (22%) nor less than fourteen percent (14%):

(a) would the cardholder agreements constitute variable rate agreements within the meaning of Article 1.04(h)(2);

(b) if such amendment can be effected through use of Article 15.05, could such amendment become effective fifteen (15) days after notice has been given to the cardholder (pursuant to federal Regulation Z) or would such amendment constitute a "change adverse to the customer" under Article 15.05 so that it could not become effective until the first billing cycle beginning more than ninety (90) days after notice to the cardholder?"

Response to Question No. 9. It is the opinion of this Office that such an agreement as described above would constitute a variable rate contract within the terms of Art. 1.04(f) and 1.04(h)(2). You have noted that the agreements will provide or will be amended to provide that the interest rate applicable to the agreement may fluctuate according to the quarterly ceiling from a low of 14% to a high of 22%. Since Regulation Z requires certain disclosures to be made in variable rate contracts it is our opinion that if the Regulation Z disclosures are given in connection with an agreement as described above the notice provisions set out in Art. 1.04(f)(1) need not be given.

As mentioned in the response to Question Number 6, it is our view that the amendment provisions of either Art. 1.04(i) or Art. 15.05 may be utilized on agreements subject to Art. 15.02(d). (Art. 1.04(i)(2) specifically provides that the parties may amend the contracts by any means permitted by other applicable law.) However, it seems that an amendment of the type

set out in Question Number 9 would have to be considered adverse to the customer. Obviously the change to the quarterly from the annualized ceiling will result in a more frequent rate adjustment period. Although it is uncertain, the chances are that for at least some time period this could result in the cardholder paying a higher rate than would have been the case had the ceiling not been changed. The important factor is that the issuer cannot know for certain in advance that a higher rate will not result. Also, it is my impression that very few if any bankcard holders have previously agreed to any type of variable rate contract. Additionally, I know of none who have agreed to a rate as high as 22%. For these reasons it is our opinion that the type of amendment mentioned in Question Number 9 would be adverse to the customer as that term is used in Art. 15.05 and that the 90 day notice requirement would be applicable if Art. 15.05 rather than Art. 1.04(i) is used.

Sincerely,

Sam Kelley
Consumer Credit Commissioner