



STATE OF TEXAS

OFFICE OF CONSUMER CREDIT COMMISSIONER

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January 25, 1984 No. 84-1

Mr. Hennon Gilbert
Z-Comp
Division of Davis-Gilbert Company, Inc.
P. O. Box 32787
San Antonio, Texas 78216

Dear Mr. Gilbert:

In your letter of August 24, 1983 you asked that we consider issuing an interpretation as to the minimum refunds of time price differential (finance charge) that are required in connection with the prepayment in full of contracts entered under either Chapter 6 or Chapter 7 that are scheduled to be repaid in other than consecutive monthly installments substantially equal in amounts. With your letter you enclosed a memorandum prepared by you in which you offered your views as to the possible lack of perception on the part of the legislature as to the possible application of the "sum of the monthly balances" method of refunding in connection with other than monthly repayment transactions and the questionable meaning of the word "proportionate" in the refunding language in the Chapters.

As you know, the question you asked is a difficult one if one relies solely upon the literal language of the statute. The language to which we refer is found in Articles 6.02(10) and 7.04 of the Texas Credit Code, Article 5069, V.T.C.S. Both statutory provisions are quoted below.

Art. 6.02 (10): "Notwithstanding the provisions of any retail installment contract to the contrary, any buyer may prepay in full the unpaid time balance thereof at any time before its final due date and, if he does so, or if the holder demands payment in full of the unpaid balance prior to its final due date, he shall receive a refund credit thereon for such prepayment or upon such demand for payment in full. The amount of such refund credit shall represent at least as great a proportion of the original time price differential, after first deducting therefrom an amount equivalent to the minimum charge authorized in this Article, as

"(a) the sum of the monthly unpaid balances under the schedule of payments in the contract (beginning as of the date after such prepayment or demand for payment in full which is the next succeeding monthly anniversary date of the due date of the first installment under the contract, or, if the prepayment or demand for payment in full is prior to the due date of the first installment under the contract, then as of the date



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after such prepayment or demand for payment in full which is the next succeeding monthly anniversary date of the date of the contract) bears to

"(b) the sum of all the monthly unpaid balances under the schedule of installment payments in the contract. Where the amount of refund credit is less than One Dollar, no refund credit need be made. On contracts payable in other than substantially equal successive monthly installments commencing one month after the date of the contract, the refund shall be computed in a manner proportionate to the above described method, having due regard for the amount of each installment and to the irregularity of each installment period.

"If, subsequent to demand of payment in full under a contract, the buyer and holder agree to reinstate such contract, they may do so and may amend the contract pursuant to Section (12) of this Article."

Art. 7.04 "REFUNDS ON PREPAYMENT:

"Notwithstanding the provisions of any retail installment contract to the contrary, any buyer may prepay it in full at any time before maturity, and if he does so, or when the holder demands payment in full of the unpaid balance of the contract before its final installment is due, the buyer is entitled to receive the following refund credit thereon:

"On a contract payable in substantially equal successive monthly installments commencing one month after the date of the contract, the amount of such refund credit shall represent at least as great a proportion of the finance charge, after first deducting therefrom an acquisition cost of Twenty-five Dollars, as (i) the sum of the monthly balances under the schedule of payments in the contract beginning as of the date after such prepayment or demand for payment in full which is the next succeeding monthly anniversary date of the due date of the first installment under the contract, or, if the prepayment or demand for payment in full is prior to the due date of the first installment under such contract, then as of the date after such prepayment or demand for payment in full, which is one month after the next succeeding monthly anniversary date of the date of such contract, bears to (ii) the sum of all the monthly balances under the schedule of payments in such contract. When the amount of refund credit is less than One Dollar no refund credit need be made. On contracts payable in other than substantially equal successive monthly installments commencing one month after the date of the contract, the refund shall be computed in a manner proportionate to the above-described method, having due regard to the amount of each installment, to the irregularity of each installment period and to the provisions of Sections (2) and (4) of Article 7.03 hereof.

"If, subsequent to demand of payment in full under a contract, the buyer and holder agree to reinstate such contract, they may do so and may amend the contract pursuant to Article 7.05 hereof."

The refunding language in the Chapters are substantially the same with the following substantive differences:

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- (1) The minimum authorized charge permitted in Chapter 6 is less than the acquisition charge permitted in Chapter 7.
- (2) If prepayment in full or demand for payment in full occurs prior to the first scheduled due date under the contract, Article 6.02(10)(a) provides that the "...next succeeding monthly anniversary date of the date of the contract..." be used in the refunding formula. Article 7.04 permits the holder of the contract to use "...one month after the next succeeding monthly anniversary date of the date of such contract..." in making the refund calculation prior to the first scheduled due date. (Emphasis added)

The statutory language seems to authorize the holder of a Chapter 6 Retail Installment Contract to retain the applicable minimum charge plus the first monthly period of time price differential (TPD) earnings if the contract is repayable in equal consecutive monthly installments and prepayment in full occurs prior to the first scheduled due date. In a like circumstance, the holder of a Chapter 7 contract may retain the acquisition charge plus two (2) months' earnings. The application of the statutory language appears to be easy to interpret and adopt in the above instances. However, as a practical matter, few retail installment contracts are scheduled so that all payment periods are one (1) month; the majority of the contracts we see have some irregularity in the first installment period. Some first installment periods may cover a term less than one (1) month but the vast majority provide for extra days beyond one (1) month in the first installment period. It is the latter type of repayment schedule that creates an illogical result by attempting to apply the sum of the monthly balances method of earnings to a transaction that is scheduled to be repaid in "slightly irregular" terms; i.e. all payments substantially equal in amounts and repayable in monthly installments except the first payment is scheduled one (1) month plus fifteen (15) days from the date of the contract. If such a contract were prepaid in full five (5) days after the contract date, the "...next succeeding monthly anniversary date of the date of the contract..." (Art. 6.02(10)(a)) would be one (1) month from the date of the contract and a date on which there is no scheduled reduction of the unpaid balance. Therefore, the earnings for the period from the contract date to one (1) month thereafter is zero since the ratio of the sum of the monthly balances under the schedule of payments to the sum of all the monthly balances under the schedule of payments remains the same as it was on the date of the contract. The first earnings under the sum of the monthly balances theory will accrue only at the end of the first payment period as scheduled.

It appears that the refunding provisions of Chapters 6 and 7 were drafted to accommodate either (1) totally "regular payment" transactions; i.e. monthly installments substantially equal in amounts with the first scheduled payment commencing one (1) month from the contract date or (2) all repayment plans that do not meet the "regular payment" criteria. Based on our understanding of industry practices and consumer needs, we do not feel that the statutory provisions provide sufficient latitude to allow sellers and buyers to enter into typical contractual agreements that contain standard refunding language; i.e. the sum of the monthly balances method (Rule of 78). We recognize it is not within our authority to establish the law. However, it is our responsibility to formularize questionable provisions of Title 79 in order to be able to enforce the various chapters of the Code. To accomplish the foregoing, we recommend the following definitive terms be used to identify a transaction made pursuant to Chapter 6 or Chapter 7 and the corresponding refunding method be used in connection with the type of transaction described.

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A "regular" payment retail installment transaction is one that includes precomputed finance charge/TPD and provides for the repayment of the indebtedness in substantially equal consecutive monthly installments with the first installment scheduled to be paid no later than one (1) month plus fifteen (15) days from the date of the contract.

An "irregular" payment retail installment transaction is one that includes precomputed finance charge/TPD and provides that the repayment of the indebtedness be scheduled in one or a combination of the following plans:

- (1) Consecutive monthly installments substantially equal in amounts but the first payment period is longer than one (1) month plus fifteen (15) days.
- (2) Installment amounts are not substantially equal.
- (3) One or more installment periods beyond the first scheduled date are longer than one (1) month.

In the event of any prepayment in full or demand for payment in full of both a "regular" and an "irregular" payment transaction prior to the first scheduled due date, the following methods are considered authorized for use to determine the amount of the maximum finance charge/TPD that can be earned and the minimum finance charge/TPD that is required to be refunded.

In addition to the applicable minimum charge permitted under Chapter 6, the holder may retain the first month's charge for any prepayment in full or demand for payment in full that occurs during the first month (as defined in Art. 2.01(j)) period of the contract plus a full monthly charge for any portion of a month that has elapsed beyond the monthly anniversary date of the date of the contract. The monthly charge shall be ascertained through use of the "sum of the digits" (Rule of 78) method of calculation on both "regular" and "irregular" payment transactions. For the purposes of this calculation only, all contracts shall be considered to have been scheduled to be repayable in equal consecutive monthly installments over the entire term of the contract. As you know, the Rule of 78 method of calculation will produce the same earning/refund amounts as the sum of the monthly balances method if all scheduled installments are equal and are repayable in consecutive monthly installments.

In addition to the acquisition cost permitted under Chapter 7, the holder may retain the first two (2) months' charges for any prepayment in full or demand for payment in full that occurs during the first month period of the contract plus a full monthly charge for any portion of a month that has elapsed beyond the monthly anniversary date of the date of the contract. The monthly charge(s) shall be ascertained as explained in the preceding paragraph.

If prepayment in full or demand for payment in full occurs on or after the first scheduled installment due date, the sum of the monthly balances method of calculation shall be used in connection with "regular" payment transactions. The accrual method shall be used in connection with "irregular" payment transactions. Under this method the holder may retain earned finance charge for the period from the date of the transaction to the date of prepayment in full, or demand for payment in full, in an amount not to exceed that

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which would accrue at the simple annual time price differential rate applicable to the contract when applied to the unpaid principal amounts determined to be outstanding from time to time according to the schedule of payments, having due regard for the amount of each scheduled installment and the time for each scheduled installment period. In the event prepayment in full or demand for payment in full occurs on a date during an installment period, the holder, in addition to finance charge earnings for the installment period or periods that have elapsed, may retain for each day elapsed from the immediately preceding installment due date to the date of prepayment in full, or demand for payment in full, the finance charge produced by applying the simple annual time price differential rate under the contract, as heretofore described, to the unpaid principal balance of the transaction determined to be outstanding according to the schedule of payments as of the immediately preceding installment due date and dividing that product by three hundred sixty-five. The Code does not authorize the compounding of unpaid accrued finance charge.

Neither Truth-In-Lending/Regulation Z nor the Texas statutes specifically requires that the method of calculating the refund of precomputed finance charge be delineated in the contract document(s). However, this Office is of the opinion that the absence of such informative language in the contract would constitute an incomplete agreement between the parties. Since we are most certain that contracts currently being entered contain the language relative to the sum of the monthly balances method and the vast majority of the contracts are repayable in substantially equal successive monthly installments commencing within one (1) month and fifteen (15) days from the date of the contract, the standard contract forms now in use should satisfy our views as to the identification and the description of the finance charge refund computations in connection with "regular" payment retail installment contracts.

We realize our approach in this instance may be subject to criticism from both legalistic and operational points of view. However, we submit that our authorized procedures produce "proportionate" refunds with respect to the different types of transactions and produce the results probably intended by the legislature.

I hope this letter will suffice for your purposes.

Sincerely,



Sam Kelley
Consumer Credit Commissioner