



STATE OF TEXAS

OFFICE OF CONSUMER CREDIT COMMISSIONER

SAM KELLEY, Commissioner

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February 24, 1984 84-3

Mr. William H. Daniel
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Fifth Floor, Republic Bank Building
900 Congress Avenue
Austin, Texas 78701

Dear Mr. Daniel:

This is in response to your letter of January 13, 1984 in which you request a statement of the position of this office with respect to several questions relating to a proposed "simple" rather than precomputed method of calculating time price differential charges on financing contracts which are subject to Chapter 7 - Article 5069, V.T.C.S. The latter portion of your letter raises certain questions concerning "manufacturer's rebates" which may be offered in connection with automobile sales which are financed. I will first respond to your questions relating to the "simple" method of time price differential computation and then discuss the "manufacturer's rebates" issues.

A portion of your letter states as follows:

"Article 5069-1.04(a) and Article 5069-1.04(n)(4) provide that, in a contract subject to Chapter 7 of Article 5069, the parties and assignees may contract for a simple or precomputed contract rate or amount not exceeding the ceilings allowed by law. The latter provision also provides that 'the rights, duties and obligations under Chapter 7, including those requiring certain refund credits in the event of prepayment or acceleration, apply 'except to the extent inconsistent with this Article (1.04)'.

"A creditor engaged in the business of purchasing motor vehicle retail installment contracts from dealers desires to use a form of contract under which the finance charge will be charged using a simple rate. The rate will conform to the ceilings in Article 5069-1.04. The contract will disclose, as required by federal law, the amount financed, and the estimated finance charge and total of payments. As required by federal law, the amount of the payments and total of payments will reflect both the principal



and estimated finance charge. However, the contract provides that the finance charge will accrue on the unpaid balance of the amount financed at the annual percentage rate disclosed until all sums due under the contract are fully paid. Each payment will be applied first to finance charge and the remainder to the amount financed.¹

"a. If the buyer pays an installment early or late the amount of that installment will remain the same, but the final maturing installment will be adjusted. For example, if a payment is received 15 days early, then the buyer will save 15 days finance charge on the principal amount included in that installment and the final payment will be reduced by that savings. If, on the other hand, the payment is 15 days late, then the buyer will be responsible for the extra 15 days finance charge on that installment so that more of the installment will be applied to interest and less to principal, therefore resulting in a larger final payment or payments.

"b. If the buyer wishes to prepay in full, then the amount necessary to prepay in full will be determined by adding to the then 'true' principal balance the actually accrued unpaid finance charge as of the date of prepayment in full.

"c. In the event that the holder of the contract accelerates the contract, then, again, the balance which the buyer will have to pay to discharge the contract as of the date of acceleration will be the true principal balance plus actually accrued unpaid finance charges as of that date. On any date after acceleration the amount owed will be the then true unpaid principal balance plus any then actually accrued unpaid finance charge as of such date. (If there are other charges owing, such as for repossession expenses, or other similar charges allowed by Chapter 7 they will also have to be paid in the event of either prepayment or acceleration)."

Without quoting your various questions concerning the above described plan I will respond to them in the order they are presented in your letter.

Although the "simple" method of computation of a rate of charge in a contract involving a time price differential is foreign to the historical concept of time price differential it is our position that such a

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method is now authorized by Article 5069-1.04(n)(4), V.T.C.S. The plan outlined in your letter would now be an authorized method of structuring a contract subject to Article 5069-Chapter 7, V.T.C.S. when using a 1.04 rate. Article 5069-7.04 provides for a method of determining refunds upon prepayment of a Chapter 7 contract, which method is referred to as the "sum of the monthly balances method" (sometimes also called the Rule of 78's). This method of refunding was a part of the original Chapter 7 when only precomputed transactions were authorized by that chapter, and such method is not appropriate for application to a transaction wherein the rate of charge is arrived at by a "simple" or "interest (time price differential) bearing" method. In our view the Article 7.04 method of refunding is in fact inconsistent with the "simple" method of earnings computation authorized by Article 1.04(n)(4) which also provides that compliance with the various provisions of Chapter 7 need not be effected if such provisions are inconsistent with Article 1.04. It is the position of this office that the refunding method set out in Article 7.04 is not applicable to a Chapter 7 contract in which the rate of charge is computed on a "simple" or "interest (time price differential) bearing" method. In such a contract the borrower's obligation at anytime is determined based upon true principal owed plus actual accrued unpaid finance charge (time price differential in a Chapter 7 contract) plus the acquisition charge if contracted for.

In view of our position expressed in the above paragraph it is our position that the portion of the Article 7.02(2) notice which would inform the debtor of a right to pay off the contract in advance and under certain conditions obtain a partial refund of the finance charge would not be an appropriate disclosure to be made in a Chapter 7 contract wherein the rate of charge is computed on a "simple" basis. Additionally, Regulation Z, Sec. 226.18(k) requires an Article 7.02(2) type of disclosure only in precomputed contracts and not in those wherein the finance charge is computed on a "simple" basis. Article 7.02(5)(d) provides that in the event of any inconsistency or conflict between the disclosure requirements of Chapter 7 and those of federal law or regulation that the inconsistent or conflicting Chapter 7 disclosures need not be given. Thus, it is our position that the Chapter 7.02(2) disclosure need not be given in a Chapter 7 contract wherein the rate of charge is computed on a simple basis but may be modified, as you suggest in your letter, to advise the creditor of a right to pay off early and "under certain conditions save a portion of the FINANCE CHARGE." (An earlier, similar position was taken by this office in Letter Interpretation No. 82-3, January 21, 1982).

It is our position that typical default charges such as authorized in Article 7.03(6) for precomputed transactions should not be assessed in addition to daily earnings in simple interest (time price differential)

contracts. The five percent of each installment or five dollar default charge is authorized on precomputed transactions because that creditor would not be earning additional days earnings for the period of nonpayment after an installment due date.

In the event a Chapter 7 contract in which the rate of charge has been computed by using the "simple" method is extended, renewed, restated or rescheduled as provided for in Article 7.05(1)(b), the new principal balance is determined as stated in that article. The new balance would include the old, unpaid principal balance as of the date of the amendment, the cost of any insurance incidental to the amendment, any additional necessary official fees and any accrued delinquency and collection charges. (Collection charges are authorized only in the event of repossession, sequestration or other action necessary to secure possession of a motor vehicle). Article 7.05(1)(b) also provides for a deduction of the prepayment refund credit required by Article 7.04 but such provision would not be applicable to a "simple" time price differential contract. Article 7.05(1)(b) also provides that the minimum charges under Article 7.03 and the acquisition costs under the refund schedule in Article 7.04 shall not apply in calculating the principal balance of the amended contract.

In the latter portion of your letter you point out that in recent years car manufacturers have on several occasions offered to make direct rebates to persons purchasing specified motor vehicles. In such situations the automobile dealer/seller sells the car for an agreed cash price and the car manufacturer (obviously a third party) makes a rebate of some amount of money to the buyer or on the buyer's behalf. Sometimes the refund is mailed to the buyer at a later date or it may be delivered to the buyer at the time of the purchase. In the case of a credit transaction the customer may assign his rights to the rebate to the dealer and have the amount of the rebate applied either as a downpayment or as a reduction in the purchase price.

The Official Staff Commentary to Regulation Z, Sec. 226.18(b)(2) provides in part as follows:

"...Similarly, in a credit sale transaction, a seller's or manufacturer's rebate may be offered to prospective purchasers of the creditor's goods or services. At the creditor's option, these amounts may be either reflected in the Truth in Lending disclosures or disregarded in the disclosures. If the creditor chooses to reflect them in the section 226.18 disclosures, rather than disregard them, they may be taken into account in any manner as part of those disclosures."

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This allows the creditor to reduce the cash price by the amount of the rebate, or to consider it as part of the down payment, or to disregard it for disclosure purposes.

Article 7.02(5)(d), as mentioned earlier in this letter, provides that in the event of an inconsistency or conflict between the disclosure requirements of Chapter 7 and those of a federal law, regulation or interpretation thereof, the requirements of the federal law, regulation or interpretation shall control and any inconsistent or conflicting disclosures required by Chapter 7 need not be made. It is the position of this office that with regard to manufacturer's rebates (not seller's rebates) the disclosure methods authorized by the Regulation Z Official Staff Commentary may be utilized by Texas creditors and that Texas law does not restrict these types of disclosures.

Sincerely,



Sam Kelley
Consumer Credit Commissioner