



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

July 27, 1984 84-7

Mr. J. Scott Sheehan
Taylor, Hays, Price, McConn
and Pickering
Attorneys at Law
400 Citicorp Center
200 Smith Street
Houston, Texas 77002

Dear Mr. Sheehan:

This is to acknowledge receipt of your letter dated June 25, 1984 in which you request the opinion of this office concerning the charging of interest on incidental overdrafts on demand deposit accounts at a bank. A portion of your letter states as follows:

"The bank proposes to amend its depository account agreements for demand deposit checking accounts whereby the bank is authorized to charge the customer (and the customer agrees to pay) interest at the rate of 18% per annum under Article 5069 - 1.04, as amended, on incidental overdrafts in the account. Interest would be imposed from the date the overdraft is incurred until it is paid. The depository account agreement will specify that the customer has no right or privilege to overdraw the account and that the bank has no duty to permit an overdraft. The depository account agreement will also specify that any such overdraft that does occur is immediately due and payable in full, with no right to defer payment thereof.

"The contract provision in question is designed to cover incidental overdrafts. An incidental overdraft might occur for instance if the bank honors items drawn against uncollected funds (i.e., the bank honors an item drawn against the account though earlier deposit items provisionally credited to the account have not yet been paid by the institution upon whom they were drawn) and the deposit items representing the uncollected funds are subsequently returned unpaid by the other institution. In this situation, the



bank would charge-back the returned items against the account and an overdraft would occur. An incidental overdraft might also occur if there are no sufficient funds in the account to pay an item drawn by the customer when the item is presented for payment. In this situation, the bank may decide to pay the item on an overdraft basis. In either situation, the bank would require immediate payment of the overdraft by the customer.

"In our view, such incidental overdrafts do not involve a revolving credit plan in which the bank in anyway obligates itself in advance to honor the items causing the overdraft or to extend credit, nor is the customer given the right or privilege to overdraft the account.

"By way of additional background, Regulation Z recognizes the incidental nature of this sort of overdraft credit. Section 226.4 (c)(3), for example, excludes from the definition of 'finance charge' charges imposed by a financial institution for paying items that overdraw an account, unless the payment of such items and the imposition of the charge were previously agreed upon in writing. 12 C.F.R. §226.4(c)(3). The Official Staff Commentary to Section 226.4(c)(3) further states that a charge on an overdraft balance computed by applying a rate of interest to the amount of the overdraft is not a finance charge, even though the consumer agrees to the charge in the account agreement, unless the financial institution agrees in writing that it will pay such items.

"The issue under consideration, of course, is not whether the proposed charge is interest or finance charge, but whether the proposed interest charge for incidental overdrafts is governed by Chapter 1 or whether it is also governed by Chapter 3, 4 or 15. Since the overdraft amount is due immediately, in fact, the amount of the overdraft becomes past due once incurred, it appears to us that Chapter 1 is the applicable chapter, not Chapters 3, 4 or 15 since, among other reasons, such chapters contemplate open-end credit with deferred payment features.

"We would appreciate an interpretation from your office whether the bank is permitted to contract for and charge interest regarding such incidental overdrafts at the rate of 18% per annum under Article 5069 - 1.04, as amended, and further, whether this sort of incidental overdraft credit is only subject to Chapter 1 of Article 5069, not Chapters 3, 4 or 15 of Article 5069."

Mr. J. Scott Sheehan
Page Three

July 27, 1984 84-7

It is the view of this office that Chapter 15, Article 5069, V.T.C.S. and the relevant sections of Chapters 3 and 4, Article 5069, contemplate a type of open-end credit agreement whereby the creditor agrees to extend credit to a debtor over an indefinite period of time in a revolving manner and further agrees to allow the debtor to defer repayment of the credit extended over a period of time. The type of credit extension described in your letter is not of this type. Apparently any extension of credit made pursuant to that program would be repayable in full immediately although as a practical matter some time would elapse prior to its repayment. Additionally, the agreement described in your letter would specify that the customer has no right or privilege to overdraw the account and that the bank has no duty to permit an overdraft.

It is the position of this office that neither Chapter 3, 4 or 15 of Article 5069 are applicable to the type of program outlined in your letter. Chapter 1 of Article 5069 is applicable to the program.

Sincerely,



Sam Kelley
Consumer Credit Commissioner