OFFICE OF
CONSUMER CREDIT
COMMISSIONER

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Commissioner

Writer's Direct Number

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Interpretation Letter Request 96-1

Ms. Karen Neeley
Independent Bankers Association of Texas
408 West Fourteenth Street
Austin, TX 78701

Dear Ms. Neeley:

You have requested an interpretation of Title 79 pursuant to the provisions of TEX. REV. CIV. STAT. ANN. art. 5069-2.02A(10) (Vernon 1995). Your request details the following queries:

- If a consumer installment loan has an interest rate of 10% or less, does Section 5.202 of the *Texas Banking Act* (*Banking Act*) permit loan fees on that loan as well as late charges?

- Since this section of the *Banking Act* specifically provides that these fees are not interest, does that mean that they are not interest for purposes of the usury law?

- Since Chapter 15 prohibits fees and charges that are not authorized by other law, does Section 5.202 constitute the "other law" and therefore authorize fees and charges if assessed by a bank?

A consumer installment loan with an interest rate of 10% or less is made under the authority of art. 5069-1.02 and the provisions of the *Texas Constitution.* The *Texas Banking Act* provides for fees and expenses as follows:

> Sec. 5.202. LOAN EXPENSES AND FEES. (a) A bank may require a borrower to pay all reasonable expenses and fees incurred in connection with the making, closing, disbursing, extending, readjusting, or renewing

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> of a loan, regardless of whether those expenses or fees are paid to third parties. A fee charged by the bank under this section may not exceed the cost the bank reasonably expects to incur in connection with the transaction to which the fee relates. Payment for these expenses may be collected by the bank from the borrower and retained by the bank or paid to a person rendering services for which a charge has been made, or the payments may be paid directly by the borrower to a third party to whom they are payable. This section does not authorize the bank to charge its borrower for payment of fees and expenses to an officer, director, manager, or managing participant of the bank for services rendered in the person's capacity as an officer, director, manager, or managing participant.
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> (b) A bank may charge a penalty for prepayment or late payment. Only one penalty may be charged by the bank on each past due payment. Unless otherwise agreed in writing, prepayment of principal must be applied on the final installment of the note or other obligation until that installment is fully paid, and further prepayments must be applied on installments in the inverse order of their maturity.
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> (c) Fees and expenses charged and collected as provided by this section are not considered a part of the interest or compensation charged by the bank for the use, forbearance, or detention of money.
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> (d) To the extent of any conflict between this section and a provision of Subtitle 2, Title 79, Revised Statutes (Article 5069-2.01 *et seq.*, Vernon's Texas Civil Statutes), or Chapter 15, Title 79, Revised Statutes (Article 5069-15.01 *et seq.*, Vernon's Texas Civil Statutes), the provision of Title 79, Revised Statutes, prevails.

These provisions authorize the assessment of expenses, fees, and penalties on loans outside of Subtitle 2, Title 79, or Chapter 15 of Title 79. Loans subject to Subtitle 2 are (1) loans made under the authority of Subtitle 2; (2) loans made under the authority of art. 1.04 extended for personal, family, or household use but not for business, commercial, investment, agricultural, or other similar purposes, or primarily for the purchase of a motor vehicle, other than a heavy commercial vehicle as defined in Section (n), art. 7.01, and that are payable in two or more installments, not secured by

a lien on real estate; or, (3) loans that are payable in monthly installments and qualify as a secondary mortgage loan as defined in art. 5.01 [art. 5069-1.04(n)(1) and (n)(2)]. A loan made by a bank written at a rate of interest authorized by art. 1.02 is outside of Subtitle 2, Title 79 or Chapter 15 of Title 79, and, thus, the provisions of the *Banking Act* apply. The assessment of fees, expenses, and penalties on such a loan would be authorized by these provisions. Therefore, the answer to your first question is yes. While these provisions authorize the assessment of additional charges, an analysis of the character of these charges is fundamental in determining whether these charges constitute interest. This, essentially, is your second question. The significance of this issue centers on whether the assessment of additional fees and charges would make the transaction usurious. The basic tenet of all usury law stems from the definition of interest: compensation for the use, forbearance, or detention of money. TEX. REV. CIV. STAT. ANN. art.5069-1.01(a) (Vernon 1987); *Cavnar v. Quality Control Parking, Inc.*, 696 S.W.2d 549, 552 (Tex. 1985).

Your second question pertains to Subsection (c) of Section 5.202 of the *Banking Act*. The language of Subsection (c) refers to "fees and expenses charged and collected." The nature of these fees or charges is very important in analyzing potential usury violations. As the Texas Supreme Court held in *Gonzales County Savings and Loan v. Freeman*, 534 S.W.2d 903 (Tex. 1976), the substance of fees and charges must be identified for their true purpose, rather than relying on the name or form of the additional charge. The court said "a charge which is in fact compensation for the use, forbearance or detention of money is, by definition, interest regardless of the label placed upon it by the lender ... where there is dispute in the evidence as to whether the charge is merely a device to conceal usury, a question of fact is raised for the jury," 534 S.W.2d 906. In any transaction whereby fees and charges could be deemed to be interest, the loan must be cautiously structured to assure that the charges are indeed reasonable in light of the actual work done to prevent the loan from being usurious.

A distinction must be made for penalty assessments such as for default or late payment. Late payment penalty charges are not expressly provided for by Subtitle 1 as an additional charge. Conversely, we find exactly the opposite in the loan chapters of Subtitle 2. In those chapters, the Legislature expressly provided for "additional interest for default." In the context of this response, the late payment penalty charge that is referenced is a charge that is assessed solely as a result of a borrower failing to tender a payment by the due date of an installment. A late payment penalty charge has historically been recognized as compensation for the use, forbearance, or detention of

money (specifically compensating for the payment being late). This charge has no direct correlation to any expense or fee charged or incurred by the lender, and does not include costs that a lender will incur in the collection of the delinquent account. Fees that are an additional charge supported by a distinctly separate and additional consideration, other than the simple lending of money, are not interest. *First Bank v. Tony's Tortilla Factory*, 877 S.W.2d 285 (Tex. 1994). Collection costs have historically only included expenses incurred in the collection of delinquent accounts. These collection costs and fees have not been included in the category of a late payment penalty charge. The category of late payment penalties has recognized charges associated with the use, forbearance, or detention of money (interest), while, the category of collection costs or fees has been associated with collection expenses. This letter assumes that the use of the phrase "late payment penalty charge" only refers to a charge by the lender against the borrower solely as result of failing to tender payment by the due date and does not include any expense incurred by the lender in the collection of the delinquent account.

You have suggested that due to the language of the *Banking Act* and the Finance Commission's administrative rule (7 TAC 12.32) that a late payment penalty charge should not be construed as interest. The language in the *Banking Act* does not provide that late charge penalties are not interest. Subsection (c) of 5.202 provides that "fees and expenses" do not constitute a part of the interest. The *Banking Act* provisions are similar but not identical to language in the *Savings and Loan Act*, as analyzed by the Supreme Court in *Gonzales County Savings and Loan v. Freeman.* In the *Gonzales* case, the Supreme Court was not persuaded that the open-ended language that fees and charges did not constitute interest was blanket authority to charge any kind of fee or penalty that the lender desired, and held that whether a fee or charge is interest, is a fact question to be determined by the judge or jury. "It is evident that the Legislature established no maximum rate allowable on those charges termed 'reasonable expenses' or 'penalties'... further, penalties need bear some reasonable relationship to the amount of loss or inconvenience suffered by the lender due to prepayment or late payment by the borrower," *Gonzales*, 534 S.W.2d 908. Several cases have construed late payment penalties to be interest, *Seiter v. Veytia*, 756 S.W.2d 303 (Tex. 1988); *Dixon v. Brooks*, 604 S.W.2d 330 (Tex. Civ. App.-Houston [14th Dist.] writ ref'd n.r.e. 678 S.W.2d 728); *Watson v. Cargill, Inc. Nutrena Division*, 573 S.W.2d 35 (Tex. Civ. App.-Waco, 1978 writ ref'd n.r.e.). Also other authorities have continued to opine that late charges do constitute "interest." For example, the United States Supreme Court in *Smiley v. Citibank (South Dakota), N.A.,* 116 S. Ct. 1730, (1996) held that late charges are a component of "interest." While not necessarily controlling in the question at hand, the

Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision have all taken the position that late charges constitute interest [12 C.F.R. Section 7.4001(a); FDIC Advisory Opinion 93-27; Letter of Karen Solomon, Deputy Chief Counsel of OTS, 94 CC-18, September 29, 1994]. As stated in Consumer Credit Commissioner Interpretation Letter 84-11 "[w]e do not consider it the function of this office to attempt by interpretation or otherwise to change or supersede existing authorities and we do not intend to do so." Certain individuals have expressed that it was the intent of the *Banking Act* to accomplish a different treatment of late charge penalties in terms of defining interest. I do not find that the provisions of Section 5.202 change the long-standing treatment of characterizing a late charge as compensation for the detention of money. If, indeed, it is the desire of the banking industry to change the definition of interest as it relates to late payment penalties, or perhaps, to provide for additional interest for default, which may be more desirable and consistent with Subtitle 2, then a legislative solution would be the appropriate means to accomplish this.

Your third question concerns the charging of fees on a revolving triparty account governed by the provisions of Chapter 15. Two statutory provisions are controlling in this analysis. Section 5.202 specifically provides that "to the extent of any conflict between this section and a provision of Subtitle 2, Title 79, Revised Statutes, or Chapter 15 of Title 79, Revised Statutes, the provision of Title 79, Revised Statutes prevails." Art. 5069-15.02(f) provides: "No fees shall be charged to or collected from the customer in connection with an account subject to this Chapter unless authorized by statute." Your question appears to reference the phrase "authorized by statute." The apparent conflict between these two statutory subsections is clear. The *Banking Act* defers to the provisions of Chapter 15. The Texas Legislature in adopting Chapter 15 did not specify which statute. Generally if the Legislature desired to restrict the application to a particular statute or section, the Legislature has employed terms that are restrictive. For example, various provisions of art. 1.04, specifically utilize the phrase "this article." When the Legislature employed the word "article," it restricted the scope. When the Legislature used the phrase "unless authorized by statute" it expanded the authority to include any Texas statute adopted by the Texas Legislature. The phrase itself is plain and unambiguous.

There are numerous Texas cases that stand for various propositions that include the phrase "unless authorized by statute." In every one of the following cases, the reference is to a different statute other than the particular statute in question: *International Turbine Service, Inc. v. Lovitt,* 881 S.W.2d 805, 808 (Tex. App.-Fort Worth 1994 writ

denied); *Burke v. Satterwhite,* 525 S.W.2d 950, 955 (Tex. 1975); *Lewis v. Lewis,* 853 S.W.2d 850, 854 (Tex. App.-Houston [14th Dist.] 1993, no writ); *City of Grand Prairie v. Sisters of the Holy Family of Nazareth,* 868 S.W.2d 835, 846 (Tex. App.-Dallas 1993, writ denied); *Bethke v. Polyco, Inc.* 730 S.W.2d 431 (Tex.App.-Dallas 1987, no writ). Therefore, the construction of the phrase "unless authorized by statute" to include references to statutes outside of Chapter 15 is reasonable.

Consequently, it appears that Section 5.202 of the *Banking Act* would not conflict with the provisions of Chapter 15 and would authorize the assessment of fees and charges. Again the analysis of substance over form becomes imperative to determine if particular fees and charges do indeed constitute interest, potentially resulting in usury violations.

Sincerely,

Leslie L. Pettijohn

LLP:jjm

Approved by the Finance Commission January 24, 1997