STATE OF TEXAS

OFFICE OF CONSUMER CREDIT COMMISSIONER

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SAM KELLEY, Commissioner

July 14, 1981 No. 81-9

Mr. Paul M. Maloney
Regional Counsel
Citicorp Person-to-Person, Inc.
11475 Olde Cabin Road
St. Louis, Missouri 63141

Dear Mr. Maloney:

This is in response to your letter dated May 22, 1981, which was one of several requests we have received concerning the question you presented. I have delayed somewhat in my reply in order to discuss this matter with a number of people and to consider the correspondence we have received related to this question.

The issue you and several others have raised basically is as follows:

> May "points" (which I consider to be a prepaid finance charge) be contracted for and collected on a secondary mortgage loan made pursuant to Chapter 5, Article 5069, V.T.C.S.?

I would first like to make some general observations. Prior to the enactment of H.B. 1228, this Office has always considered it to be improper for a lender to contract for a prepaid finance charge in connection with a Chapter 5 loan. One of the primary considerations for this position has been the language of Articles 5.02(1) and (2) which authorized an add-on interest charge of $8 per $100 per annum and required that the interest charged be added to the cash advance at the time the loan was made. That being the case, there was no authorization for any type of prepaid interest or "points." Also, Article 5.02(5) prohibited any charges other than authorized by Chapter 5.

Also, this response is based on the assumption that if called upon to decide the question, the Texas Supreme Court would hold that "points" and any other prepaid finance charge, no matter how denominated, would be considered interest. Gonzalez County Savings and Loan Association v. Freeman, 534 SW2d 903, (Sup. Ct. Tex. 1976); American Savings and Loan Association v. United States, Civil No. H-77-833 (S.D. Tex. 1978). In the latter case, which was not a final decision but only a ruling on a motion for summary judgment (the case was later settled), the court stated the following:

> "Therefore, the court finds that where such a loan discount is truly -- albeit indirectly -- paid by a borrower, the Texas Supreme Court would find such a payment to be interest, such as where the debtor is obligated to reimburse the one making the payment or where the purchase price of property is increased above the market value to reflect the contemplated payment of a loan discount by the seller to induce the making of a loan to the buyer."

The court was of course speaking of "sellers points" in this case, but surely the same reasoning would be applicable to "borrowers points" or prepaid interest. I mention these court cases only to illustrate why I assume the Texas Supreme Court would consider "points" to be interest.

As mentioned earlier, prior to enactment of H B. 1228, Chapter 5 authorized only add-on precomputed interest on a Chapter 5 contract. Article 1.04(4) now provides as follows:

> "In any contract, including a contract for an open-end account, which is subject to Chapters 4, 5, 6, 6A, or 7 of this Title, the parties and their assignees may contract for any rate or amount allowed by that Chapter, or any simple or precomputed contract rate or amount not exceeding those allowed by this Article, but except to the extent inconsistent with this Article in any event the parties to any contract under any of such Chapters or to any contract under Chapter 3 of this Title shall comply with all of the other rights, duties, and obligations under the applicable Chapter and the parties and their assignees have all other rights under the applicable Chapter, including those provisions requiring certain refund credits in event of prepayment or acceleration "

As can be seen from the above language, simple interest (interest bearing) contracts are now authorized for Chapter 5 transactions. Our past position with regard to points not being permitted on precomputed Chapter 5 contracts is still, we believe, sound and we believe H B. 1228 did nothing to alter that view as far as precomputed contracts are concerned. However, we have reached a different conclusion with regard to simple interest (interest bearing) contracts Article 5.02(6), added to Chapter 5 by H B. 1228, provides:

> "(6) As an alternative to the rate provided for by Section (1) of this Article, the parties may agree to any rate not exceeding a rate authorized by Article 1.04 of this Title."

In effect this new section states that as an alternative to the $8 add-on, precomputed interest authorized by Article 5 02(1), the parties may agree to and contract for the Article 1.04 rates which may be precomputed or simple interest.

In a precomputed Chapter 5 contract but with Article 1.04 rates, our earlier position with respect to points would still be applicable. However, if the note were simple interest (interest bearing), the provisions of Chapter 5 relating to the treatment of precomputed interest would of course not be applicable. Therefore, on those types of loans, "points" may be charged and any such charge would be considered as interest. Since "points" would be interest they would have to be included with the remainder of the interest charges in calculating the appropriate annual percentage rate on the contract. Also, it would be imperative that the inclusion of "points" in the total interest charge did not increase the overall interest yield on the contract beyond the appropriate interest ceiling.

Additionally, I am of the opinion that the provisions of Article 1.07(a) would be applicable to an interest-bearing Chapter 5 loan made pursuant to the provisions of Article 1.04. Said Article 1.07(a) would not, however, be applicable on any precomputed Chapter 5 loan even if made pursuant to Article 1.04 provisions since the provisions of Chapter 5 relating to the treatment of precomputed interest remain in effect.

Sincerely yours,

Sam Kelley

Sam Kelley
Commissioner