STATE OF TEX/

OFFICE OF CONSUMER CREDIT COMMISSIONEI

SAM KELLEY, Commissioner

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September 23, 1981 No. 81-21

Mr. Donald N. Goldston
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1000 Southwest Tower
7th and Brazos Streets
Austin, Texas 78701

Dear Mr. Goldston:

This is to acknowledge receipt of your letter dated June 29, 1981 wherein you pose several questions concerning Article 5069, V.T.C.S., as recently amended by H.B. 1228.

I will first set out your hypothetical example followed by your questions and my responses thereto. Your example is:

> "A Texas lender and a Texas borrower wish to enter into a contract which will result in the latter obtaining from the former a closed-end loan for personal, family or household use. Both parties are also willing to enter into a contract which provides for the rate of interest charged against the outstanding principal balance of the loan to "float" or vary in accordance with a lawful index. If the loan is secured, it will not be secured by a one to four family residence or by any residential property in which the borrower resides or intends to reside. The loan will not include any pre-computed interest; interest will be computed on a simple interest basis."

> "Question (1): Assuming that the parties will agree to the quarterly ceiling, may they lawfully agree to fix the interest rate ceiling, until the loan has been repaid, at the quarterly ceiling in force on the date on which such contract is entered into?"

Response: Since in your example you indicate that the parties will agree that the interest rate will "float" according to a lawful index, I am assuming this to be a variable rate contract subject to the provisions of Article 1.04(f). In a variable rate contract, we are of the opinion that the ceiling may not be fixed for the term of the contract at, for example, the quarterly ceiling at the time the contract is entered into. The second sentence of Article 1.04(f) states, "However, the rate or amount so produced may not exceed the ceiling that may from time to time be in effect and applicable to the contract, for so long as the debt is outstanding." This indicates that the Legislature intended that the ceiling in a variable rate contract change if and when the ceiling rate applicable to the contract changed. Contrast the above-quoted language to that of Article 1.04(e) which allows the parties in a closed-end, fixed rate contract to agree to the quarterly ceiling for the term of the contract. The difference in language seems significant, and if the Legislature had intended that the initial quarterly ceiling in a closed-end, variable rate contract would not have to change on the statutory dates they would not have used the above-quoted words from Article 1.04(f).

> "Question (2): May the same parties lawfully agree in such contract to fix the interest rate ceiling, until the loan has been repaid, at the quarterly ceiling in force on the date on which such contract is entered into or at the quarterly ceiling in force on the date on which the loan is funded, whichever is higher?"

Response: I would make the same response as that given to your first question since we are of the opinion that in a variable rate contract based upon the quarterly ceiling that the ceiling must be adjusted quarterly and may not be fixed for the life of the contract. I would point out, however, that the parties to a variable rate contract based upon the quarterly average could not agree to one or the other averages, since the only one applicable would be the one in effect at the time the interest accrues. The ceiling applicable to the contract, in this case the quarterly, will continue to be subject to change during the life of the contract.

> "Question (3). May the same parties lawfully agree in such contract for the interest rate ceiling to "float" or vary, until the loan has been repaid, in accordance with any changes in the quarterly ceiling?"

Response. I believe the above two responses indicate that I believe it mandatory that in a variable rate contract subject to Article 1.04(f) the ceiling must "float."

Your second hypothetical example is as follows:

> "A Texas lender and a Texas borrower wish to enter into a contract which will result in the latter obtaining from the former a closed-end loan for other than personal, family or household use. Both parties are also willing to enter into a contract which provides for the rate of interest charged against the outstanding principal balance of the loan to "float" or vary in accordance with a lawful index. If the loan is secured, it will not be

secured by a one to four family residence or by any residential property in which the borrower resides or intends to reside. The loan will not include any precomputed interest; the interest will be computed on a simple interest basis."

"Question (4): Assuming that the parties will agree to the monthly ceiling, may they lawfully agree to fix the interest rate ceiling, until the loan has been repaid, at the monthly ceiling in force on the date on which such contract is entered into?"

Response: No. As stated earlier, we are of the opinion that ceilings in variable rate contracts must "float."

"Question (5): May the same parties lawfully agree in such contract to fix the interest rate ceiling, until the loan has been repaid, at the monthly ceiling in force on the date on which such contract is entered into or at the monthly ceiling in force on the date on which the loan is funded, whichever is higher?"

Response: No. The reasoning stated in the response to your second question is applicable to this question.

"Question (6): May the same parties lawfully agree in such contract for the interest rate ceiling to "float" or vary until the loan has been repaid, in accordance with any changes in the monthly ceiling?"

Response: Yes. We are of the opinion that ceilings in variable rate contracts must "float."

Sincerely yours,

Sam Kelley

Sam Kelley
Consumer Credit Commissioner