HOUSE
RESEARCH
ORGANIZATION bill analysis 5/6/1999

HB 2337
Ehrhardt

SUBJECT: Allowing late charges for simple interest consumer transactions

COMMITTEE: Financial Institutions — favorable, without amendment

VOTE: 9 ayes — Averitt, Solomons, Denny, Ehrhardt, Elkins, Grusendorf, Marchant, Pitts, Juan Solis

0 nays

WITNESSES: For — Karen Neeley, Independent Bankers Association of Texas

Against — Rob Schneider, Consumers Union

BACKGROUND: Late charges are not permitted on simple interest consumer loans in Texas, but they are permitted for certain precomputed loans. For a simple interest loan, interest is charged on the remaining principal following each installment payment. If a simple interest loan is prepaid, then any remaining interest is avoided.

For precomputed loans, the total amount of interest to be charged over the length of the loan is added to the principal, and this total is divided into equal installment payments. Since a total amount of interest already is figured into a precomputed loan, people who pay these loans off early are entitled to a rebate of interest based on the "Rule of 78s," which is a mathematical formula that distributes more of the interest into the early installments of the loan.

The federal Internal Revenue Service (IRS) recently amended tax accounting rules to require that interest on consumer installment transactions be reported on a simple interest, or constant yield, basis. Precomputed loans still are permitted by state and federal law but must be accounted for as though they were simple interest loans.

DIGEST: HB 2337 would amend art. 5069-3A, VTCS, and chp. 342, Finance Code, as applicable, to authorize lenders to charge a late fee when an installment payment on a simple interest loan is 10 days late. This late fee could not exceed 5 percent of the amount of the installment. A late fee could not be collected more than once on the same installment.

The bill would take effect on September 1, 1999.

SUPPORTERS SAY:

HB 2337 would help consumers because it would encourage lenders to switch to simple interest loans, which are fairer to consumers than precomputed loans. Simple interest loans give consumers greater reward for prepaying their loan and are simpler to understand.

The late charge is wholly avoidable by the consumer. All that they must do to avoid the charge is to pay their installments by the 10th day after the due date. Consumers who are consistently delinquent will face late charges, as they should, because delinquency creates costs on the part of the lender. The ability to assess late fees enables banks to handle a customer's delinquency on an installment without having to demand the a substantial portion of the balance or entire balance be paid in full immediately.

Complying with federal accounting rules has increased the complexity of bookkeeping for lenders that use precomputed loans. However, this inconvenience is itself not enough to convince banks to switch entirely to simple interest loans because they have no ability under current law to assess late fees for delinquent customers.

OPPONENTS SAY:

The bill essentially would allow lenders to collect double interest payments in months when a consumer cannot make a scheduled payment on time. For simple interest loans, the lender collects additional interest on the principal if payments are not made on time. Precomputed loans do not collect this additional interest when a payment is late, because the total amount of interest already has been calculated into the payments. Thus, late fees make sense only for precomputed loans because the lender otherwise would gain nothing from a late payment. Lenders should not be able to collect a fee on top of the additional interest that accrues when an installment is delayed.