BILL ANALYSIS

Senate Research Center
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H.B. 1979
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Engrossed

AUTHOR'S / SPONSOR'S STATEMENT OF INTENT

Commercial transactions are governed by Chapter 306 (Commercial Transactions) of the Texas Finance Code. Current law authorizes calculating commercial interest based upon a 360-day year consisting of 12 30-day months (the "360/30 Day Month Method"). The current provision is silent as to any other acceptable methods of calculating interest and does not explicitly prohibit any methods. It is generally presumed that a lender may use any method that does not result in an effective rate of interest exceeding the applicable usury ceiling, which is the highest price, interest rate, or other numerical factor allowable in a financial transaction. Two commonly accepted methods to calculate commercial interest are the "365/360" method and "paid in kind."

The "365/360" method results in an interest rate that is slightly higher than what is stated in the promissory note. The reasoning behind this approach goes to the bank's attempts to standardized interest rates based on a 30-day month, while taking into account the 365-day calendar year. The "paid in kind" method refers to a type of compounded interest normally applicable to large commercial loans. The original promissory pays down the principal and some of the interest. The rest of the accruing, unpaid interest is rolled over into a new promissory note, which is paid down separately and at the same interest rate as the original promissory note for the principal.

Texas courts have long supported both methods, based on the reasoning that accrued interest is a separate obligation from the loan's principal, therefore the lender may lawfully charge interest on that separate obligation. Despite approval from the courts, practitioners are hesitant to apply either approach in large commercial transactions.

H.B. 1979 states that a lender and a borrower may calculate the interest on a commercial loan using the "paid in kind" method, the "365/360" method, the method in the existing law, or any other method otherwise permitted by law. H.B. 1979 also confirms that the provisions in Chapter 306 of the Finance Code are meant as safe-harbors and are not intended to affect or negatively impact loans made under other provisions of the chapter.

H.B. 1979 amends current law relating to interest on commercial loans.

RULEMAKING AUTHORITY

This bill does not expressly grant any additional rulemaking authority to a state officer, institution, or agency.

SECTION BY SECTION ANALYSIS

SECTION 1. Amends Section 306.002, Finance Code, by adding Subsection (c), to provide that the provisions of this chapter providing authorizations with respect to certain transactions do not affect or negatively impact any rules of law applicable either to other transactions subject to this chapter or to any transactions not subject to this chapter.

SECTION 2. Amends Section 306.003, Finance Code, as follows:

> Sec. 306.003. COMPUTATION OF LOAN TERMS. (a) Authorizes a creditor and an obligor, in addition to any other method otherwise permitted under this title, to agree to compute an annual interest rate on a commercial loan on a 365/360 basis or a 366/360

basis, as applicable, determined by applying the ratio of the percentage annual interest rate agreed to by the parties over a year of 360 days, multiplied by the outstanding principal balance, multiplied by the actual number of days the principal balance is outstanding. Authorizes a creditor and an obligor to also agree to compute the term and rate of a commercial loan based on a 360-day year consisting of 12 30-day months. Authorizes each interest rate ceiling under Chapter 302 (Interest Rates) and 303 (Optional Rate Ceilings) expressed as a rate per year to mean a rate per year computed in accordance with this section. Deletes existing text authorizing, for purposes of this chapter, each rate ceiling expressed as a rate per year to mean a rate per year consisting of 360 days and of 12 30-day months.

(b) Authorizes a creditor and an obligor to agree that one or more payments of interest due or that are scheduled to be due with respect to a commercial loan to be paid on a periodic basis when due wholly or partly by adding to the principal balance of the loan the amount of unpaid interest due or scheduled to be due, regardless of whether the interest added to the principal balance is evidenced by an existing or a separate promissory note or other agreement. Provides that on and after the date an amount of interest is added to the principal balance under this subsection, that amount no longer constitutes interest, but instead constitutes part of the principal for purposes of calculating the maximum lawful rate or amount of interest on the loan.

SECTION 3. Makes application of this Act prospective.

SECTION 4. Effective date: September 1, 2013.