BILL ANALYSIS

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S.B. 952
By: Carona
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AUTHOR'S / SPONSOR'S STATEMENT OF INTENT

Two commonly accepted practices to calculate commercial loans include using the "365/360" day method and allowing interest to be compounded or "paid-in-kind" by adding the amount of accrued, but unpaid, interest on the loan to the principal balance of the loan. The "365/360" day method attempts to standardize 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 on commercial loans where the borrower may, in lieu of paying interest in cash, defer payment thereof. The deferred interest can be added to the outstanding principal balance of the loan or the borrower can provide a new note to the lender. In either event, interest will accrue on both the original principal balance and the deferred interest, typically at the same interest rate as the original promissory note for the principal.

Texas courts have long supported compounding interest based on the reasoning that accrued interest is a separate obligation from the original principal balance of the loan, therefore the lender may lawfully charge interest on that separate obligation. However, despite the courts' approval of the "paid-in-kind" method and the acceptance of the "365/360" method in the commercial lending community, practitioners are hesitant to apply either approach in large commercial transactions because the Finance Code does not expressly authorize their use. Chapter 306 (Commercial Transactions) authorizes calculating commercial interest based on a 360-day year consisting of twelve 30-day months (the "360/30 Day Month Method"). The law is silent as to any other acceptable method of calculating commercial interest.

S.B. 952 authorizes a lender and a borrower to calculate the interest on a commercial loan using the "paid-in-kind" method, the "365/360" method, or any other method otherwise permitted by law. S.B. 952 also confirms that the provisions in Chapter 306, Finance Code, are meant to serve as safe-harbor provisions and are not intended to affect or negatively impact loans made under other provisions of the chapter.

As proposed, S.B. 952 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. New heading: 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, 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, rather than authorizing each rate ceiling expressed as a rate per year, for purposes of this chapter, to mean a rate per year consisting of 360 days and 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 is authorized to be paid on a periodic basis when due, but not more often than monthly, 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 the changes in law made by this Act prospective.

SECTION 4. Effective date: September 1, 2013.