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Uniform Consumer Credit Code
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ADMINISTRATIVE INTERPRETATION

No. 2.201, 3.201 and 3.508-8301

NO REFUND OF PREPAID FINANCE CHARGES ON NONPRECOMPUTED CONSUMER CREDIT TRANSACTIONS IS REQUIRED BY THE RATE CEILING PROVISIONS OF THE CODE IN THE EVENT OF PREPAYMENT UNLESS SUCH PREPAYMENT IS SCHEDULED OR ANTICIPATED AND NOT A RESULT OF DEFAULT.

In response to numerous inquiries concerning refund of prepaid finance charges, the administrator issues the following administrative interpretation. The issue is whether the rate ceiling provisions of the U.C.C.C. (5-2-201, 5-3-201, and 5-3-508) on nonprecomputed loans or sales require a creditor to refund prepaid finance charges in the amount by which total finance charges exceed the applicable rate ceiling. It is my opinion that such rebate is not required by the code, unless the prepayment is scheduled or anticipated and not a result of default.

For example, assume a $10,000 interest bearing consumer loan with monthly "interest only" payments and the entire principal to be paid in 1 year. The "interest rate" is 12 percent. A loan fee of $700 is paid at closing. The resulting APR is approximately 20.43 percent. If the $10,000 loan is paid off at the end of 6 months, the lender will have earned $600 interest and will have received an additional $700 in prepaid finance charges.

Preliminarily, code section 5-3-210 requires rebate of unearned finance charges upon prepayment of a "precomputed" loan. Prior to H.B. 1585 (1981 Colo. Sess. Laws, p. 389), "precomputed" loans as defined by 5-3-107(2) included "interest bearing" loans on which a significant portion of the finance charge was prepaid (added to the principal). Admin. Interp. 3.107-7901, rescinded after H.B. 1585. H.B. 1585 made clear that this type of "precomputed" transaction existed only if the prepaid finance charges were 50 percent of the total finance charges. Although the definition 1/ still encompasses the usual "precomputed" loan

(rent expressed as sum of principal and finance charge), "interest bearing" loans require no rebate of unearned finance charges (i.e., at the disclosed rate), when outside the 50 percent test.2/

Other state U.C.C.C. administrators have analyzed prepaid finance charges under the code ban on "prepayment penalties" (C.R.S. 1973, 5-3-209). Letter by Dwight D. Bonham, Wyoming (Sept. 14, 1974) reprinted in Cons. Cred. Guide (C.C.H.) transfer binder, para. 98,741. However, the clear intent of H.B. 1585 was to require rebate of prepaid finance charges on interest bearing loans only if the prepaids are 50 percent of the total finance charges. Tapes of House Bus. Aff. & Labor Committee, Feb. 10 and 22, 1981 (H.B. 1151: predecessor to final H.B. 1585). Although we are charged with a duty to keep rules and interpretations consistent with other code jurisdictions, the Colorado legislature made a clear expression of rebate requirements for unearned finance charges. Legislative intent is of crucial importance. C.R.S. 1973, 2-4-203; Train v. Colorado Public Interest Research Group, Inc., 426 U.S. 1 (1976). Furthermore, although the distinction makes little economic sense, prepayment penalties historically have referred only to an additional sum exacted at the time of prepayment. 75 A.L.R.2d 1265.

However, C.R.S. 1973, 5-3-508 indicates that "a supervised lender may contract for and receive a loan finance charge not exceeding that permitted by this section." By illustration, the "flat rate" for closed end loans is "twenty-one percent per year on the unpaid balances of the principal." C.R.S. 1973, 5-3-508(2)(b). The inclusion of the word "receive" may indicate that the creditor must recalculate the loan upon prepayment to ascertain if the loan finance charge paid exceeds the rate ceiling expressed as an annual rate. On the above-described $10,000 loan prepaid at 9 months, the finance charge paid is $1300 (700 600). The resulting APR if recalculated is approximately 27.9 percent. Must the lender refund those finance charges in excess of 21 percent?

The argument is made that the absence of an express rebate provision for prepaid finance charges in excess of the rate ceiling means no such requirement was intended. I do not find this persuasive. The legislature simply was not faced with the issue since "points" customarily have only been received on mortgage loans exempt from the code. But, "points" and other prepaid finance charges are now being received in connection with a wide variety of consumer loans. The rate ceiling language itself requires refunds of excess charges, once identified. The question is whether excess charges exist in the case of prepayment.

Although there is contrary authority, generally, voluntary prepayment does not render usurious a loan otherwise free of usury. Ware v. Traveler's Indemnity Co., ___ Tex. App. ___, 604 S.W.2d 400 (1980); 75 A.L.R.2d 1265.

Prior Colorado law contained provisions similar to those in the code:

> No person shall charge or receive a greater rate of interest upon any loan or upon any unpaid balance after any partial payment on any loan made by him than two per cent per month....

C.R.S. 1963, 73-2-5.

Lederman Enterprises, Inc. v. Westinghouse Credit Corporation, 347 F. Supp. 1291 (D. Colo. 1972), held that the voluntary prepayment of a loan did not render the loan usurious in violation of the above statute, since the amount received was less than the amount contracted. No clear intent to change Colorado law was manifested in the adoption of the Colorado version of the U.C.C.C. The subsequent legislative history of the Colorado code made clear that no recalculation and refund was required except in the precomputed transaction. (H.B. 1585, 1981 Colo. Sess. Laws, p. 389). Additionally, even the true interest bearing transaction is not subject to recalculation of the amortization schedule in case of certain partial prepayments. C.R.S. 1973, 5-3-20, as amended by H.B. 1585, 1981 Colo. Sess. Laws, p. 390.

Similarly, acceleration upon borrower's default does not render a loan usurious that is not usurious on its face. Industrial National Bank v. Stuart, 113 R.I. 124, 318 A.2d 452 (1974); 66 A.L.R.3d 650. While many jurisdictions have followed this principle only if the lender does not actually receive the usurious amount, the same rationale should apply as in the case of voluntary prepayment. Default is in control of the debtor and is not a scheduled or anticipated event.

"Policy" arguments concerning the cost and difficulty of recalculation have also been advanced, as well as possible adverse effect on the secondary market for real estate secured loans. Such concerns, while relevant, are not the culmination or the analysis. The code balances these costs against the obvious benefits to consumers from substantive protection.

Nevertheless, the code's provisions indicate that disclo-

sure and calculation of the rate is made on the assumption that all scheduled payments will be made when due (C.R.S. 1973, 5-3-508(4)(a) and parallel provisions). While expressly applicable only to "precomputed" loans, the policy would be consistent for interest bearing loans with the precomputed feature of prepaid finance charges. Consequently, the code merely requires that the originally scheduled "interest bearing" transaction be in compliance with the rate ceiling provisions.

However, no similar result entails if prepayment is scheduled or anticipated. The same code provisions that allow a transactional view of rate ceilings also require that the lender take account of the scheduled payments in control of the lender. Thus, a call provision allowing the lender to require payment in full at the lender's discretion requires compliance with the rate ceiling sections of the code at the time of such "scheduled" payment. Further, if the scheduled transaction were a sham designed to increase the term (and maximum allowable charges), with the actual scheduled transaction coterminous with the prepayment, the language and intent of the code would require compliance with the rate ceilings. To do otherwise would be to place form over substance and to counsel illegal subversion of the code provisions. However, absent these considerations, no refund of prepaid finance charges is required by the rate ceiling provisions of the Colorado U.C.C.C. in the event of prepayment.2/

1/ C.R.S. 1973, 5-3-107(2) provides:

> (2) A loan, refinancing, or consolidation is "precomputed" only if the debt is expressed as a sum comprising the principal and the amount of the loan finance charge computed in advance or, if any portion of the loan finance charge is prepaid, the amount of that portion of the loan finance charge either computed in advance or prepaid constitutes more than one-half of the total loan finance charge applicable to the loan, refinancing, or consolidation.

2/ The authors of an article appearing at 11 Colo. Law. 2557 (Oct. 1982) raise the question as to whether the 50 percent calculation must again be made at the time of prepayment. For many of the same reasons cited in support of this interpretation regarding the effect of rate ceilings, no such recalculation is required in the event of prepayment.

3/ The administrator acknowledges receipt of creditor suggestions that the opinion address scheduled transactions rather than "control" of prepayment. These suggestions have been incorporated. On the other hand, concern was expressed that the interpretation was not limited to the Colorado statute. This interpretation is necessitated by the Colorado modifications of the Code and is based on that amended Colorado statute.

By: Martin D. Stuber
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Colorado Uniform Consumer Credit Code

This is an official interpretation of the Colorado Uniform Consumer Credit Code as contemplated in C.R.S. 1973, 5-6-104(4), as amended.

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