

January 22, 1997

Re: Application of Late Charge Payments

Dear Mr. _____ :

This letter is in response to your correspondence of November 15, 1996 in which you inquired as to the proper application of delinquent payments. The issue you raise is whether the language of W. Va. Code § 46A-3-113(3) determines how delinquent installment payments are to be credited in calculating the unpaid loan balance, or whether it only determines how such payments are to be applied for purposes of the imposition of late fees.

Upon review of the statutory language, together with the applicable legislative rules governing credit transactions and the original commentary to the UCCC, I have concluded that W. Va. Code § 46A-3-113(3)'s provisions on payments allocation governs only the determination of late fees. Therefore, your proposal for _____, NA to apply delinquent installment payments on nonprecomputed loans first to accrued interest, then to late payments owed and then to principal reduction to be both legal and proper. Provided, however, that for purposes of determining whether any late payment has accrued, the delinquent installment shall be applied first to the current installment, then to any past owing installment, and then to late charges owed-- in accordance with W. Va. Code § 46A-3-113(3). This would be consistent with the interpretive Advisory Letter from the Indiana Department of Financial Institutions you cited regarding that state's analogous UCCC provision. (Ind. Code Ann. § 24-4.5-3-204).

West Virginia Code § 46A-3-113(3) provides that:

*No delinquency charge may be collected on an installment which is paid in full within ten days after its scheduled due date, even though an earlier maturing installment or a delinquency or deferral charge on an earlier installment may not have been paid in full. **For purposes of this subsection, payments shall be applied first to current installments, then to delinquent installments, and then to delinquency and other charges.*** (Emphasis added).

The primary purpose of the above underlined language is to prevent the pyramiding of late charges. Otherwise a lender could allocate the payments so that once one installment was late, there would be a late charge on all subsequent installment payments, since the late charge would be deducted from the future installments submitted, and each such payment would therefore not be sufficient to fully pay the installment due.

The commentary to Section 2.502(3) of the 1974 Uniform Consumer Credit Code on which the West Virginia statute was based, gave the following example of prohibited conduct: a \$100 payment being due on January 1st is received on January 15th resulting in a \$5 late fee; and when the \$100 payment is made on February 1st the creditor would deduct \$5 to first cover the late payment owed, making the payment for February only \$95 and thereby causing a new \$5 penalty since the owing installment had not been paid in full. (See CCH Consumer Credit Guide ¶ 6093 reprinting UCCC 1974 version).

But the question of the application of payments for purposes of determining whether a late payment is owed, is not the same as the issue of application of payments for purposes of determining the amounts of accrued unpaid interest and the remaining principal balance under the actuarial method. Legislative rule 106 CSR § 1-2.1 states that the:

Actuarial method: means the method, defined by rules adopted by the commissioner, of allocating payments made on a debt between principal or amount financed and loan finance charge or sales finance charge pursuant to which a payment is applied first to the accumulated loan finance charge or sales finance charge and the balance is applied to the unpaid principal or unpaid amount financed. (Emphasis added).

Nonprecomputed loans to which W. Va. Code § 46A-3-113 applies are generally simple interest loans calculated in accordance with the actuarial method. Following the application of payments order in W. Va. Code § 46A-3-113(3) for purposes of such loan calculations would conflict with the actuarial method. To avoid this conflict presently applies the delinquent installment first to unpaid and owing accumulated loan finance charges, then to unpaid principal, then to any late charges owing. As this results in the accumulation of unpaid late charges remaining outstanding until the end of the loan,

is proposing to apply the delinquent installment first to accumulated finance charges, then to late charges, and then to the unpaid principal.

You cite in support of such an allocation method subsection (2) to W. Va. Code § 46A-3-113 which states that a “delinquency charge may be collected at the time it accrues or at any time thereafter.” Further, it can be contended that support for the proposed allocation method is found in the language of subsection (3) itself, which clearly states that the allocation of payments set forth therein is “[f]or purposes of this subsection” and therefore should not be viewed as limiting how payments are to be applied for purposes of determining the unpaid loan balance.

This proposed allocation method results in the consumer essentially paying interest on the late charge amount, since the deduction of the late charge from the payment before its application to principal leaves a higher outstanding principal balance in that same amount upon which interest accumulates. But, adopting this method which has the practical result of charging interest on the late fee would not violate state law prohibitions against charging interest on interest, since late fees are not part of interest under the WVCCPA. State law also provides that additional charges permitted by W. Va. Code § 46A-3-109 which are due but not paid, are counted as part of principal and are subject to finance charges. See, W. Va. Code § 46A-1-102(36). Lastly, recent amendments to our banking rules have permitted both cash advance charges and over-the-limit fees on credit cards, which fees if not paid upon their initial assessment become subject to finance charges. See 106 CSR § 11-4.1 and -5.1 (treating such fees as additional charges). Thus it would not be inconsistent to permit a payment allocation method under which unpaid late charges essentially accrue finance charges.

It appears that when faced with the same issue, Indiana’s Department of Financial Institutions, in interpreting its similar UCCC provision in Ind. Code Ann. § 24-4.5-3-203.5, has allowed late charges to be deducted from delinquent payments prior to principal reduction. This approach is implied in its Advisory Letter of September 10, 1973 which states that: “*while any number of earned delinquency charges may be deducted from a specific payment, such charges cannot be considered unpaid on the scheduled installments.*” (Advisory Letter, 9/10/73 reprinted in CCH Consumer Credit Guide ¶ 6902). However, the Advisory Letter concerned a precomputed loan, and thus did not address the effect of having late charges deducted from payments in a manner which altered the amount of finance charges owed over the term of the loan. Nevertheless, it is true that based upon the removal of a section of their state code prohibiting accrual of interest on late charges, that Indiana now does permit the application of late payments under the method proposed by . While the legislative directive is not so clear in West Virginia (the WVCCPA does not, and never did, address the issue of interest on late charges), the statutory language would seem to permit it. In any event, as a technical matter under the proposal, interest is not actually being assessed on the late charges, interest is merely being

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assessed on the unpaid principal, which principal amount is not being reduced as quickly when the late charges are deducted prior to the installment payment being applied to principal.

If you have any questions regarding this letter, please contact me.

Sincerely,

Timothy C. Winslow
General Counsel