

January 30, 1979

Dear

I am writing in response to your letter of December 21, 1978, in which you outlined generally your comments as to why you believe that the "payment holiday" provision in your credit contracts do not create what is commonly referred to as a "balloon payment" situation which is in violation of 9A MRSA, Section 3-308 of The Maine Consumer Credit Code. I have conducted an exhaustive research of the question using as reference material, The Maine Consumer Credit Code, The 6th Redraft and Final Draft of The Uniform Consumer Credit Code, The Commissioners' Comments with respect to relevant sections in the Uniform Consumer Credit Code and a Law Review article by John A. Spanogle, Jr., Professor of Law, University of Maine School of Law.

Essentially, the "payment holiday" referenced above is a contractual provision contained in the United Canal Bank Secured Note and Disclosure Form located under the caption, OTHER TERMS that permits the consumer to omit a regularly scheduled payment provided that five consecutive payments have been made. The consumer isn't even expected to pay the accrued interest at the time, and interest will continue to accrue until the next regularly scheduled payment is made. Furthermore, the omission of a payment will not constitute a default.

Focusing upon Section 3-308 of the Code with respect to Balloon Payments, my first observation is the non-uniform language contained therein as compared to the provision on balloon payments in the Uniform Consumer Credit Code. Please review Section 3-308, subsection 1 of our code which is as follows:

1. No creditor shall at any time contract for or receive payments pursuant to a schedule of payments under which any payment is not substantially equal to all other payments, excluding any down payment receivable by the creditor or under which the intervals between any consecutive payments differ substantially.
(emphasis supplied)

I conclude that the schedule of payments in the "payment holiday" note is not restricted to the repayment schedule that is disclosed, but also encompasses the contractual provision offering the payment holiday. The only criteria necessary to be eligible for a payment holiday is that five consecutive payments have been made. No other prerequisites are necessary. Consequently, the intervals between payments are not substantially equal as there is a significant departure from a typical repayment schedule calling for monthly payments. Like clockwork, there would be six interruptions in a 36 months contract that ultimately would be repaid in 42 months.

More important, perhaps, is the language contained in a companion section of the Code, namely Section 2-308. The intent of this Section is impliedly set forth in the Commissioners' Official Comments to this Section (copy enclosed) and in Professor Spanogle's Law Review (copy pertaining to Section 2-308 enclosed). It is an inescapable fact that the intent of this section is to provide set maturities for supervised loans of \$1,000 or less (The \$1,000 has since been increased to \$1,400). The inclusion in a contract that allows the consumer to automatically skip payments without any reason or qualification can ultimately result in a violation of this Section. I am fully aware that

deferrals are permitted on precomputed loans and interest only payments are permitted on interest bearing loans, but prudent lending practices historically allow these extensions in instances where the consumer may be experiencing bone fide hardship and an evaluation is made by the creditor to determine if the customer's circumstances are such as to warrant an extension. Again, I wish to emphasize that the only prerequisite in your program is that the consumer simply has made five consecutive payments. In a hypothetical situation, let's assume that your bank has entered into a supervised loan (APR in excess of 12¼%) for \$1,200, repayable in 37 months. Let's also assume that the payment holiday provision is exercised by the consumer. The 37 months loan would then be extended to 42 months, which would be clearly violative of Section 2-308 and arguably, Section 3-308.

I conclude that your present payment holiday provision is violative of Section 2-308 in instances where the credit contracts are written for the maximum or close to the maximum duration as set forth in this section and also violative of 3-308 of The Maine Consumer Credit Code and the practice must cease. If you wish to have a clause in your contracts referencing the fact that interest only payments may be acceptable, in the event of unanticipated adverse circumstances, we would raise no objections generally, but would reserve the right to review the precise terminology you may use.

I trust that this letter is sufficiently responsive to your inquiry but if further communications are necessary, do not hesitate to contact me.

Yours truly,

Harry W. Giddinge
Acting Superintendent

HWG/erb
Enclosures