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## Department of Justice

### MEMORANDUM

FROM: Kathleen Keest, Deputy Administrator, ICCC  
DATE: September 14, 1999  
RE: Change in terms requirements on open-end accounts

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This memo discusses the interplay between state and federal law regarding change in terms requirements on open-end credit accounts.

#### *A. Background*

Creditors are increasingly seeking to unilaterally change the contract terms on open-end credit accounts, particularly credit card accounts. They do so, for example to a) modify the contract to increase fees, or add new categories of fees; b) modify the contract to increase (or, less frequently, decrease) the interest rate either by changing the contracted-for margin or index on a variable-rate account;<sup>1</sup> c) modify the contract to add to the list of events which can trigger a rate change, such as to provide for so-called "penalty rates." (A "penalty" rate category provides, for example, that if the creditor deems itself insecure, or if there are two missed payments, etc., the rate will rise from the normal "prime + 9%" to "prime + 13%.")

In considering when and how such changes can be made, it is critical to keep in mind that contracts (in theory) are "freely negotiated" as to terms. (However, many consumer credit

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<sup>1</sup> Note that this is different than a rate change which occurs as a result of a market change in the index rate previously contracted for in a variable-rate contract. Truth in Lending rules provide that its change of terms requirements do not apply to "rate increases under a properly disclosed variable-rate plan." Reg. Z, Official Staff Commentary § 226.9(c)-1. ICCC Informal Advisory # 46 states: "in an open-end credit plan where the creditor can demonstrate compliance with the variable rate disclosure provisions of the TILA, there is no need to comply with ICCC § 537.3205. (Lowe to Nilles, May 21, 1987). See also Inf. Adv. # 56 (Cleland to Comes, February 10, 1989) ("Compliance with [the TIL variable rate disclosure rules] would eliminate the need to send out change of terms notices each time the finance charge increases or decreases.")

contracts today are adhesion contracts, where the contract is offered on a take-it-or-leave-it basis, and terms are not subject to negotiation.) Fundamental common law contract principles place certain limitations on the right of one party to unilaterally change the terms of a contract previously agreed upon.

Since there is uneven bargaining power, and consumer credit contracts are typically adhesion contracts, with standardized terms offered on a take-it-or-leave it basis, and are not negotiable, Congress and states have set some minimum standards to assure that some semblance of the fundamental principles of a contract as the subject of mutual agreement is maintained.<sup>2</sup>

***B. Interrelationship between the federal Truth in Lending Act and the Iowa Consumer Credit Code -- General Principles***

Truth in Lending is a *disclosure* law. With few exceptions, it does not preempt or affect state *substantive* contract law or credit regulation. It does not

annul, alter or affect in any manner the meaning, scope or applicability of the laws of any State, including, but not limited to the types, amounts or rates of charges, or any element or elements of charges, permissible under such laws in connection with the extension or use of credit....

15 U.S.C. § 1610(b). Furthermore, with certain enumerated exceptions not listed here, it does not affect the validity or enforceability of contracts. 15 U.S.C. § 1610(d). State laws regulating the terms of credit and charge card accounts are not preempted. OSC § 226.28(d)-3.<sup>3</sup>

As to state *disclosure* requirements, TIL preempts them only to the extent of any inconsistency. 15 U.S.C. § 1610(a); Reg. Z § 226.28. Generally, if a creditor can comply with state law without violating the federal law regarding disclosures, it is not inconsistent. See OSC § 226.28(a)(2),(3).

***C. TIL disclosure rules regarding change in terms on non-HELC<sup>4</sup> open-end accounts***

TIL provides that whenever certain terms in an open-end account will be changed by the

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<sup>2</sup> The issue of unilateral change in terms on open-end accounts comes up most often in the credit card context. The federal law prohibits unilateral changes in terms in open-end accounts secured by the equity in consumers' homes (home equity lines of credit, or HELCs). 15 USC § 1647(c)(1); Reg. Z, § 226.5b(f)(3).

<sup>3</sup> An example of a state law relating to credit cards which is not preempted by TIL is one that requires credit card issuers to offer a grace period. OSC § 226.28(d)-3.

<sup>4</sup> See note 2.

creditor,<sup>5</sup> or the minimum payment is to be increased, a written notice must be "mailed or delivered" at least 15 days prior to the effective date of the change. (emphasis added). Reg. Z § 226.9(c)(1). In two situations, TIL mandates written notice prior to the effective date of the change, but it can be less than 15 days: if the consumer agrees to the change, or if the interest rate or finance charge is increased because of default or delinquency.

TIL does not mandate an advance change in terms notice for the following changes: changes involving late payment charges; charges for documentary evidence, or OTL (over-the-limit) charges; a reduction in finance or other charges; suspension of future credit privileges or termination of the account; when court proceedings are involved, or when non-finance charge changes resulting from default or delinquency are made. Reg. Z § 226.9(c)(2). See also OSC § 226.9(c)(2)-1 (also mentioning change in credit limit, change in name of the credit card or card plan; substitution of insurers.)

[NOTE: These are the rules for a change in terms on existing accounts. There are separate rules for "renewals" of credit or charge cards, which this memo does not discuss. See Reg. Z § 226.9(e).]

#### *D. ICCC substantive rules on change in terms*

In contrast to the TIL minimum advance notice disclosure rules, the ICCC addresses the question of unilateral change in terms as a matter of substantive regulation, and as a contract matter. It addresses how a consumer can signify that he or she chooses not to continue the contractual relationship under the proposed unilateral change in terms. The UCCC rules are designed "to allow creditors to change the terms of their open-end accounts in a manner which is feasible from their standpoint but which safeguards the interests of their customers." It recognizes that changes may be warranted from time to time, and that obtaining affirmative written consent to the change from all cardholders is impracticable. However, "merchants and banks should not be permitted to take advantage of customers by changes which are unfair, unanticipated, or inadequately communicated." Comment to UCCC § 3.205 [1974]

Iowa Code § 537.3205 permits a creditor to change the terms of an open-end credit account under the following conditions:

\* As to future balances: The creditor may change the terms as to balances incurred after the effective date of the change if it mailed or delivered written notice 60 days before the effective date. (This assures that the consumer has ample time to receive the notice, and opt not to use the account again after the effective date.) ICCC § 537.3205(1)

\* As to existing balances: Except as specifically authorized by the ICCC, or unless

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<sup>5</sup> For non home-equity secured accounts, those terms include: the terms relating to how the finance charge will be determined; other charges; security interests; or billing rights.

agreed to by the consumer,<sup>6</sup> an adverse change cannot affect an existing balance. Adverse change includes an increase in the rate of finance charge or other charges, or an increase in the amount of the periodic payment, or which otherwise adversely affects the interests of the consumer with respect to the balance. However, the statute provides that, as a matter of law, the consumer manifests consent to this proposed unilateral change in terms if he or she uses the account after the effective date. (That applies only if the 60-day advance notice so warns the consumer that this will be the case.)<sup>7</sup>

*E. Interplay of TIL and ICCC regarding change in terms rules*

The TIL 15-day notice requirement was in place when the ICCC was written. The primary drafters of the ICCC explained that the change in terms requirements of the ICCC are "in addition to the change in terms provisions of Regulation Z...." Butler and Wallace, A Compliance Guide to the Iowa Consumer Credit Code, p. 5.10 (Iowa Bankers Assoc. 1974)<sup>8</sup>

This is consistent with TIL's preemption principles. To the extent that Iowa law sets minimum requirements as to how changes in terms of an existing account are effectuated as a matter of substantive contract and consumer protection law, TIL has no bearing on the matter at all. (See Sec. B.) To the extent that Iowa law would require longer advance notice for change in terms on a credit card account as a matter of disclosure, TIL would not preempt it, because the creditor can comply with Iowa law without violating TIL's rules. TIL requires "at least" 15 days notice, and 60 days is "at least" 15. (See also ICCC Inf. Adv. # 56, Cleland to Combs, Feb. 10, 1989). While TIL does not require a change in terms notice for some events, neither does it prohibit them. Since it does not prohibit them, a creditor can comply with the ICCC without violating TIL. Hence, even viewing § 537.3205 as a disclosure matter, rather than the substantive law that it really is, it would not be preempted in the credit card context.

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<sup>6</sup> This means the consumer's specific written consent. See Comment, UCCC § 3.205(2) [1974] (NB: Iowa's version differs from the model change in terms, but not in this respect); Butler and Wallace, A Compliance Guide to the Iowa Consumer Credit Code (Iowa Bankers Assoc. 1974) (the creditor must either obtain the customer's actual consent... (emphasis added)). [Mr. Butler, then of NCUSL, and Mr. Wallace, then of the Univ. of Iowa faculty, were the primary drafters of the ICCC.] Thus, boilerplate consent in the initial cardholder agreement would not suffice.

<sup>7</sup> In a subsequent non-uniform amendment, the legislature enacted an exception to this: with advance 60 days notice, the change in terms can be applied to existing balances without regard to whether the consumer has assented, explicitly or by implication through subsequent use, if the account was part of a bulk acquisition of a portfolio of accounts. ICCC § 537.3205(3).

<sup>8</sup> See note 6. While the Butler and Wallace guide is not official legislative history, their paper should be instructive as to the information the enacting legislature would have had about the import and intent of the ICCC when it was enacted, as they were the primary drafters of the law.

## SUMMARY:

- \* **HELCs:** As to open-end Home Equity Lines of Credit (HELCs), Truth in Lending's prohibition against unilateral change in terms preempts a creditor's right under the ICCC to change terms upon 60 days notice.
- \* **Credit Cards:** As to credit card change in terms, there is no conflict between TIL and the ICCC. Creditors may easily comply with the ICCC without violating the TIL. The ICCC rules are also sound policy, because they recognize the fundamental violation of contract principles and fairness that letting the party to a contract with superior bargaining power go back and change the rules after the fact.
- \* **Variable-rate contracts:** Rate changes which occur as a result of a market change in the index rate previously contracted for are not "changes in terms" which are subject to the ICCC change-of-terms rule, provided that variable-rate disclosures were made in compliance with applicable Truth in Lending rules.