

THOMAS J. MILLER  
ATTORNEY GENERAL

CONSUMER PROTECTION DIVISION



Address Reply To:  
Hoover Bldg., 1305 E. Walnut  
Des Moines, Iowa 50319  
Telephone: 515-281-5926  
Toll Free: 888-777-4590 (In Iowa)  
Fax: 515-281-6771  
[www.IowaAttorneyGeneral.org](http://www.IowaAttorneyGeneral.org)

## Department of Justice

July 27, 2012

### Via Electronic and Standard Mail



RE: Applying increased credit card APR to outstanding balances

Dear [REDACTED],

This letter is in response to your inquiry to Shauna Shields regarding the ability of a creditor to increase the APR on a credit card and apply the new finance charge retroactively to the outstanding balance of debtors. Ms. Shields forwarded your question to me to answer as Deputy Administrator of the Iowa Consumer Credit Code. Bear in mind that this letter represents only an informal review by our office based on the information you provided; it is not a formal opinion of the Attorney General nor is it legal advice.

You indicated in your message that [REDACTED] mistakenly issued some credit cards to Iowa consumers with an APR of 15% rather than the intended rate of 16.9%. [REDACTED] now plans to correct the mistake and increase the APR for those consumers to 16.9%. Although [REDACTED] intends to notify the consumers of the rate increase and wait the 60 days as required by statute before applying the new rate, [REDACTED] ability to apply the new rate to any outstanding balance held by the consumers prior to the increase remains ambiguous.

The Iowa Consumer Credit Code (ICCC) regulates credit arrangements like this one when Iowa consumers are involved. Iowa Code § 537.3205 addresses the protocol for modifying the terms of open-ended credit accounts like credit cards. The ICCC contains a notification provision in § 537.3205(1) allowing creditors to change the terms, including the APR, of open-end credit accounts, “[w]hether or not a change is authorized by prior agreement,” provided they give account holders

sixty days' notice. However, the law limits the application of changes made under that provision to charges that accrue after the new terms take effect. As for changes to terms that apply to the outstanding balance, the ICCC states in § 537.3205(2) that:

a creditor shall not change the terms of an open-end credit account, with respect to a balance incurred before the effective date of the change, which results in an increase of the rate of the finance charge or other charge or an increase in the amount of a periodic payment due, or which otherwise adversely affects the interests of the consumer with respect to the balance.

Such a change may apply retroactively to the outstanding balance, however, if the account holder agrees to the new terms. According to Iowa Code § 537.3205(2), the account holder "agrees" within the meaning of the statute if he receives the same sixty day notification mandated for non-retroactive changes and, most importantly, uses the credit card "*after* the effective date of the change . . . ." (emphasis added).

The ICCC is an adaptation of the 1974 version of the Uniform Consumer Credit Code (UCCC). The ICCC's provision dealing with changes in terms of open-end credit accounts is therefore similar to the UCCC's provision on point, and the comments to that model statute help inform a reading of the ICCC. A comment that accompanies UCCC § 3.205 discusses the impracticality of requiring lenders and banks that issue credit cards to countless individual consumers to obtain from each cardholder written agreements to any change in terms. The commentators to the UCCC note the infrequency with which consumers take the affirmative step of returning consent forms as support for this proposition.

The comment to UCCC § 3.205 concludes, however, that lenders "should not be permitted to take advantage of customers by changes which are unfair, unanticipated, or inadequately communicated" and emphasizes that the purpose of the statute remains "safeguard[ing] the interests of . . . consumers." This sentiment echoes the stated purposes of the ICCC, which, as outlined in § 537.1102, include "[p]rotect[ing] consumers against unfair practices by some suppliers . . . of consumer credit, having due regard for the interests of legitimate and scrupulous creditors," and "[p]ermit[ting] and encourag[ing] the development of fair and economically sound consumer credit practices."

When applied to the facts at hand, the ICCC and UCCC collectively suggest that the overall purpose guiding these laws favors an interpretation of Iowa Code § 537.3205 that protects consumers from "agreeing" to increases in their APR merely by virtue of receiving a formal notice, which they are unlikely to read, and subsequently using their credit card. Reading the law to the contrary would seem to run counter to the ICCC's purpose of "[p]rotect[ing] consumers against unfair practices by some suppliers . . . of consumer credit." Nevertheless, the agreement language of Iowa Code § 537.3205 could be read to allow a credit card provider to apply an increased APR to a consumer's outstanding balance if that consumer uses the card after receiving notice of the change.

The ICCC is not the last word on this topic, however. Included in the ICCC's statement of purpose is "[c]onform[ing] the regulation of disclosure in consumer credit transactions to the Truth in Lending Act." It explains this further in § 537.3201, specifying that anyone subject to duties or obligations under the Truth in Lending Act (TILA) "shall make or give to the consumer the disclosures, information and notices required of the person by that Act and *in all respects shall comply with that Act.*" (emphasis added) The ICCC therefore incorporates the provisions of TILA.

The TILA has its own rules for credit card transactions, rules that changed after Congress passed the Credit Card Accountability, Responsibility and Disclosures (CARD) Act in 2009. The Credit CARD Act amended TILA to include specific provisions on consumer lending through credit cards. One of the additions made in the Credit CARD Act is a general prohibition on levying increased interest rates, fees, or charges on a cardholder's outstanding balance. Specifically, the law reads: "[i]n the case of any credit card account under an open end consumer credit plan, no creditor may increase any annual percentage rate, fee, or finance charge applicable to any outstanding balance, except as permitted . . . ."<sup>1</sup>

Before analyzing the exception circumstances under which the Credit CARD Act allows lenders to apply an increased APR to a borrower's outstanding balance, it is important to understand what constitutes an outstanding balance. The Act defines the term as "the amount owed on a credit card account under an open end consumer credit plan as of the 14th day after the date on which the creditor provides notice of an increase in the annual percentage rate, fee, or finance charge."<sup>2</sup> The Federal Reserve Board captures the meaning of this provision more evocatively, referring, in its regulation implementing TILA, to a "protected balance" to which increased APRs, fees, and other charges cannot apply unless they qualify for an exception.<sup>3</sup>

The Credit CARD Act enumerates four exceptions to the general prohibition against applying an increased APR to a consumer's outstanding or protected balance: promotional APRs, variable rate APRs, delinquent payments, and failure on the part of the borrower to abide by a hardship arrangement. The exception for promotional APRs applies only when the creditor clearly and conspicuously discloses to the consumer both the "length of the [promotional] period and the annual percentage rate that would apply after expiration of the period."<sup>4</sup> In addition, the new APR cannot exceed the amount initially disclosed. Lenders may increase a variable rate APR, provided the APR is pegged to an index that is publicly available and not under the lender's control, and the rate increase derives from an increase in the index.<sup>5</sup> Late payments by the cardholder may only result in an increased APR if the payment is more than sixty days late, and even in that case the law provides ways for the cardholder to return to the original APR in the future.<sup>6</sup> The temporary hardship exception applies only if the lender clearly and conspicuously communicates to the borrower the consequences of failing to comply with the terms of the agreement, and under no circumstances may the increased rate exceed the rate the cardholder enjoyed prior to the arrangement.<sup>7</sup>

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<sup>1</sup> 15 U.S.C.A. § 1637(i).

<sup>2</sup> 15 U.S.C.A. § 1666i-1(d).

<sup>3</sup> Federal Reserve Board, Truth in Lending (Regulation Z), 12 C.F.R. § 226.55(c)(1).

<sup>4</sup> 15 U.S.C.A. § 1666i-1(b)(1).

<sup>5</sup> Federal Reserve Board, Truth in Lending (Regulation Z), 12 C.F.R. § 226.55(b)(2).

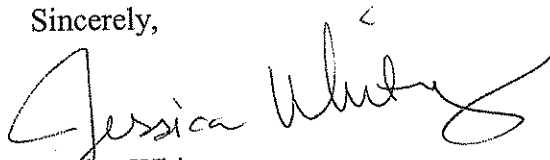
<sup>6</sup> 15 U.S.C.A. § 1666i-1(b)(4).

<sup>7</sup> 15 U.S.C.A. § 1666i-1(b)(3).

In the case at hand, the proposed retroactive increase in APR does not fit any of the exceptions. [REDACTED] claimed that the reason for the increase is to correct a mistake. The fact that the increase will institute the rate [REDACTED] intended to charge all along strongly suggests it is neither a promotional nor a variable rate within the meaning of the Credit CARD Act. There is no mention of any customers missing payments or not complying with special temporary hardship arrangements, making those exceptions irrelevant. Therefore, it is the opinion of this office that the outstanding balances held by [REDACTED] cardholders, and incurred within 14 days of receiving notice of the change, would not be subject to the increased annual percentage rate under the Credit CARD Act's amendments to TILA, as incorporated by the ICCC. This would be true even if [REDACTED] provides the required sixty days' notice and the cardholder, without manifesting any other form of agreement, uses the card after the change takes effect.

Please note that this is an informal opinion of the Administrator; it is neither an official opinion of the Attorney General nor a formal ruling of the Administrator. It does not replace or provide legal advice. If you have any further questions, please contact me at the above phone number or address.

Sincerely,

A handwritten signature in cursive script that reads "Jessica Whitney".

Jessica Whitney  
Assistant Attorney General  
Deputy Administrator-Iowa Consumer Credit Code

JW

cc: Shauna Shields