



# The State of South Carolina

## Department of Consumer Affairs

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ELIMINATION OF "FREE RIDE" ON A LENDER CREDIT CARD ACCOUNT IS A CHANGE SUBJECT TO § 37-3-408(1) CONDITIONS; "BALANCE" MEANS THE AMOUNT USED TO DETERMINE FINANCE CHARGE.

A national bank plans to eliminate its 25 day "free ride" period for its lender credit card accounts, the time during which a consumer may presently pay 100% of the existing balance on his account and avoid further finance charges on goods and services. Questions arise concerning the applicability of Consumer Protection Code § 37-3-408 (Cum. Supp. 1980) which provides until July 1, 1982 in subsection (1):

Whether or not a change is authorized by prior agreement, a creditor may change the terms of a revolving loan account applying to any balance incurred before or after the effective date of the change. If the change increases the rate of the loan finance charge or of additional charges, alters the method of determining the balance upon which charges are made so that increased charges may result, or imposes or increases minimum charges, the change is effective with respect to a balance incurred before the effective date of the change only if the debtor after receiving disclosure of the change agrees to it in writing or the creditor delivers or mails to the debtor one written disclosure of the change at least 30 days before the effective date and the debtor incurs additional debt on or after that date. (Emphasis added).

A lender credit card account is a type of revolving loan account [see Administrative Interpretations No. 3.201-8111 of September 16, 1981 at 1 and No. 3.303-7617 of December 3, 1976 at 1] and therefore is subject to the requirements in § 37-3-408(1) for written agreement or advance notice plus continued use of the account prior to making certain changes in terms of the account. (Advance notice under the Truth in Lending Act [15 U.S.C. § 1601 *et seq*] and revised Federal Reserve Board Regulation Z § 226.9(c) [12 C.F.R. § 226] is not in question.)

The initial question is whether § 37-3-408(1)'s conditions apply to elimination of the free ride period in a lender credit card account. In our opinion the answer is yes because it is an alteration of the "method of determining the balance upon which charges are made" with resulting increased charges to a person who could otherwise take advantage of the free ride if it were available. While a more typical change involving balances would be switching from one method of determining the balance for purposes of figuring finance charges to another--such as from the "adjusted balance method" to the "average daily balance method"--it is our

TELEPHONES (AREA CODE 803)

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opinion that elimination of a free ride period also qualifies as a change triggering this section's conditions. When the consumer chooses the option of taking a free ride, there is no balance on which to calculate a finance charge. When the free ride option is eliminated, a finance charge is calculated on a balance at some point during a billing cycle even if the consumer pays off his entire existing balance each month. A consumer who has taken advantage of the free ride under the present terms will have increased charges when the new terms take effect.

This is just the kind of change that should require either a written agreement between the bank and the consumer or notice far enough in advance allowing the consumer to decide how to react to the change and plan accordingly. For instance, if the consumer is simply a convenience user who pays off his account balance in full each month rather than someone who uses the account to budget his purchases by making smaller monthly payments, he may decide to quit using his card, take one last free ride, and subsequently intend to pay cash for his purchases. To insure that he never incurs finance charges in the future, he may surrender his card. Or he may keep it to use only in emergencies. Or he may decide that the convenience of the card justifies the new charges and continue his use as before. Use of the card under either of these last two options will trigger the new term. A consumer who has not used the free ride consistently, as well as one who has, also needs sufficient time to decide whether to continue using the card although he will lose his free ride option in the future if he does.

Current Consumer Protection Code § 37-3-408(1) is based on § 3.205 of the Official 1974 Text of the Uniform Consumer Credit Code ("UCCC") with a significant difference. (§ 37-3-408 was amended by § 27 of Act No. 686 of 1976 to conform substantially to 1974 UCCC § 3.205. It was amended again by § 5 of Act No. 433 of 1980 to the current language which is scheduled to expire July 1, 1982.) Instead of the uniform requirement of two written disclosures (the first at least three months in advance) prior to a change resulting in increased charges applicable to a balance already incurred, only one written disclosure 30 days in advance is necessary plus an additional requirement that the consumer incur additional debt on or after the effective date of the change. The Official Comment to UCCC § 3.205 says that:

[B]anks should not be permitted to take advantage of customers by changes which are unfair, unanticipated, or inadequately communicated. This provision is 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... [I]f the change increases credit costs for consumers and applies to balances already incurred, the creditor must either obtain the consumer's written consent to the change or comply with the notice provisions of this section, as well as comply with Truth in Lending.

If the elimination of the free ride period will apply to a balance incurred before the date of the change, assuming there is no written

agreement to the change, it is the opinion of this Department that § 37-3-408(1)'s requirements of advance notice and use of the card apply.

Because of our determination that § 37-3-408's conditions generally apply to elimination of the free ride, you asked whether an account which is not activated after the conversion date, but continues to make minimum payments and accrue finance charges on an existing balance, must be offered a free ride period or its equivalent until the existing balance is liquidated. In our opinion the answer is yes (assuming there is no written agreement to the changed term). As a practical matter, this means that a consumer who does not use his account after the effective date of the change must be given the opportunity to make his final payment, liquidating his account balance, without incurring a subsequent finance charge.

To illustrate, assume the following simplified fact situation. A consumer has an existing balance of \$1,000 as of the effective date of the change, after having received timely notice of elimination of the free ride. He makes no further use of his credit card but continues to pay \$50 per month toward liquidation of his account balance. The account continues to accrue finance charges under the original terms. After paying \$50 per month for a number of months, he has paid down his balance until he receives a final statement showing a balance of \$50. He pays \$50 within 25 days of his billing date. The bank may not charge him one last finance charge on the account because he paid 100% of the new balance within 25 days, the equivalent of the free ride period.

Likewise, if instead of paying \$50 every month until liquidation of the balance, the consumer pays \$50 per month for several months and then decides to pay off the remaining balance in his account (e.g., \$600) all at once within 25 days of the date of the statement reflecting that amount, he may do so without incurring further finance charges.

The key to determining whether this section's requirements apply to a proposed change in terms is whether "increased charges may result" from the change and if so, whether the change will apply to a balance already incurred. If in fact the bank will allow a consumer who no longer uses his credit card to liquidate his account balance without receiving a final statement requiring payment of additional finance charges, there is no increased charge to that consumer. For example, if a consumer who has not used his card since the date of the change pays his entire \$600 balance and is not billed for a further finance charge (e.g., 22% APR + 12 months  $\times$  \$600 = \$11), no increased charge has resulted. In other words, if the bank forgives the finance charge which would otherwise have accrued when a payment has been made liquidating the existing balance, there is no increased charge. A creditor may have such a policy whether or not he offers a free ride in the traditional sense. That is, even if there is no free ride according to the agreement or even apparently to the disclosures, a creditor may as a matter of policy not charge the last finance charge after an account balance has been liquidated. See CPC § 37-1-107(3) (1976) and Revised FRB Reg. Z §§ 226.6(a)(4) n.13 and 226.7(d) n.14 [12 CFR § 226].

The same question also arises in connection with the bank's few lender credit card accounts remaining which still have the option of taking a free ride when only 90% of the existing balance is paid within 25 days of the billing date. This category of consumers exists because apparently they neither gave written consent to the changed term requiring payment of 100% of the balance to get a free ride instead of only 90% nor used their cards since this earlier change occurred some time ago.

The analysis is the same. May increased charges result if the free ride is eliminated, affecting balances incurred before the change? If so, the consumer is entitled to notice at least 30 days prior to the effective date and he must use his credit card on or after that date before the change applies to him. When and if he uses his card, the new term applies. However, these consumers, like those prompting the first question, have not used their cards in some time and may be unlikely to do so in the future. Under this section, as we interpret it, the consumer has the option of paying off his account using the 90% free ride until the balance is liquidated, assuming he does not use the card in the interim or agree in writing to the change.

Your next question is: On non-revolving accounts (those which pay out within the free ride period) where purchases were made prior to the conversion date but did not post until after the conversion date (and therefore were not part of the existing balance on the conversion date), must a free ride be offered as to these transactions? The bank does not begin accruing finance charges on a transaction until the transaction is actually posted to the account.

Section 37-3-408 speaks of changing the terms applying to any "balance," a word which is not defined. Other sections of the Consumer Protection Code, however, are helpful in determining its meaning. The bank's lender credit card account is subject to maximum charges under § 37-3-201(2)(b) (Cum. Supp. 1980) which refers to § 37-2-207 containing maximum finance charges for revolving charge accounts. Section 37-2-207(2) (Cum. Supp. 1980) provides alternatives for calculating the finance charge on various "balances" of the account such as the average daily balance or the unpaid balance on the same day of the billing cycle. In our opinion, the term "balance" for purposes of § 37-3-408 means the amount on which the lender determines the finance charge. If a lender were to compute finance charges from the date of purchase, the amount of the purchase would become part of the balance on the date of the purchase. However, when a lender computes finance charges only from the date of posting, as in your question, the purchase amount does not become part of the balance until the date of posting regardless of when the item was purchased. The answer to your question is no, a free ride need not be offered for transactions made prior to but posted after the conversion date when finance charges accrue from posting, assuming the bank does not manipulate posting these amounts to circumvent the law.

In summary, it is the opinion of this Department that elimination of a free ride period on a lender credit card account is a type of change

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subject to § 37-3-408(1)'s conditions. Elimination of the free ride, however, could only result in increased charges to a consumer who at some point takes advantage of the opportunity to pay his account balance in full (or for a small number of consumers, who pay 90%). A consumer who does not use his credit card after the effective date of the change continues to have, in essence, the free ride option until his account is liquidated, assuming he has not agreed in writing to the change. In other words, after paying off the existing balance in full he cannot be assessed further finance charges. Finally, the "balance" is the amount on which finance charges are computed with the result that the posting date rather than the purchase date determines which amounts are included in the balance for purposes of changing terms if finance charges accrue only from the posting date.

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