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August 23, 1996

UCCC MATERIAL
FOR YOUR INFORMATION

RE: "Slow Pay" Credit Card Rate Provision

Dear :

This letter responds to your July 1, 1996 and August 14, 1996 letters requesting an opinion as to the permissibility of your client's desire to impose a "slow pay" credit card rate provision for its lender credit card accounts.

Your client is a Colorado state chartered bank. The bank offers Visa and Mastercard credit cards at variable rates of interest. The variable rate is a bank prime loan rate plus a certain number of points. There are a number of different programs such as prime plus 2.9% and prime plus 5.9%. Existing cardholder agreements set a maximum annual percentage rate ("APR") of 18% per annum.

Your client wishes to implement a program by which debtors who fail to pay the full minimum monthly payment on time for two consecutive months will then have to pay a fixed annual percentage rate of 18% for the next 12 months rather than the original variable rate. After the 12 months has ended, the account is reviewed and may either be reduced or remain at the fixed 18% APR for the next 12 months, depending on the debtor's payment record during that time period. The question is whether this is permitted under the Colorado Uniform Consumer Credit Code ("UCCC").

The answer to this question is not completely clear. It depends on whether the rate increase from a variable rate with a cap of 18% to a fixed annual percentage rate of 18%, due to two months of a "slow pay" record, constitutes a default charge. The UCCC clearly does not permit a lender to contract for default charges other than those provided in section 5-3-405, C.R.S. or elsewhere in the UCCC. The permitted default charges listed are:

1. Reasonable expenses in realizing on a security interest, such as repossession costs;

2. Attorney's fees, generally of 15% of the unpaid debt after default and referral to an attorney not a salaried employee of the debtor pursuant to sections 5-3-404 and 5-3-514, C.R.S.; and

3. Delinquency charges for late payment imposed pursuant to section 5-3-203, C.R.S.

This provision does not permit a default rate of interest higher than the original contract rate. See First National Bank v. Union Tavern Corp., 794 P.2d 261 (Colo. App. 1990); Official Comment to section 5-3-405, C.R.S. referencing UCCC section 5-2-414, the parallel default charges provision applicable to consumer credit sales. If your client's slow pay program is a default charge, it is prohibited on UCCC transactions.

The UCCC uses the phrases "delinquency" and "default" as those they refer to separate events, although the terms are not defined. For example, the definition of "loan finance charge" states that charges for default and delinquency fees may be excluded from the finance charge. Section 5-3-109, C.R.S. "Delinquency" is used in connection with late fees which may be imposed for payments not made within 10 days of the payment due date. Section 5-3-203, C.R.S. A deferral charge on a precomputed account may be imposed before or after default. Section 5-3-204, C.R.S.

"Delinquency" tends to refer to a payment which is late or overdue. The implication is that the original contract terms are still in effect and the lender will continue to extend credit on a revolving account. "Default" seems to refer to a later period in time or a significant breach of the contract to the extent that the lender will not permit the original contract terms to remain in effect. "Default" generally occurs after a delinquency has not been cured. The lender will typically accelerate the balance of the obligation, repossess any collateral, terminate the available credit on a revolving account, assign the account to a collection agency, file a lawsuit against the debtor, or take other final action.

Your client intends to continue to advance credit under the revolving account but at the higher annual percentage rate. The account remains open and the account is reviewed after 12 months for possible lowering of the rate. The balance on the credit card after the two consecutive months of slow pay is not accelerated. It therefore is probable that the slow pay program does not constitute a delinquency fee.

My predecessor, UCCC Administrator Martin D. Stuber, reached the opposite conclusion in an October 8, 1986 unofficial opinion letter entitled "Credit Card Interest Rate Program." In my June 24, 1992 unofficial opinion letter entitled "Discounted APR for Certain Credit Card Customer," I reached the conclusion that a lender's reduction of the contracted for APR for "good paying"

customers, was not a prohibited default charge. Your client's program is not structured as a decrease from the contract rate for good paying customers but as an increase from the contracted rate for existing "slow paying" customers, or an increase of either temporary or permanent nature for such customers as disclosed in new cardholder agreements to be issued in the future. I feel confident that a decrease from a contracted rate for good payment or other good behavior is not a default charge. Since your client's practice is structured differently, whether or not the program constitutes a default charge is not completely clear. However, our current enforcement policy would be that your client's specific slow pay program is not a default charge.

In the event your client determines to implement the slow pay program as described, it will be required to provide a change in terms notice which complies with UCCC section 5-3-408, C.R.S. for all current Colorado cardholders. You should also ensure that your client complies with the disclosure requirements of the UCCC and the federal Truth in Lending Act, 15 U.S.C. § 1601 and Regulation Z, 12 CFR § 226.

Please feel free to contact me if you have any questions or need copies of the two unofficial opinion letters cited above.

Sincerely,

Laura E. Udis

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