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FEDERAL RESERVE AND FEDERAL TRADE COMMISSION ISSUE RISK-BASED PRICING NOTICE RULE

JAMES A. HUIZINGA, KARL F. KAUFMANN, MICHAEL F. McENENEY, AND
RYAN H. ROGERS

This article explains the risk-based pricing notice rule enacted by the Board of Governors of the Federal Reserve System and the Federal Trade Commission. The rule provides a general requirement describing when a creditor must provide risk-based pricing notices to consumers, and provides several alternative methods a creditor may use to determine whether notice is required. The article also describes several exceptions to the notice requirement.

The Board of Governors of the Federal Reserve System (“Board”) and the Federal Trade Commission (“FTC”) (together, “Agencies”) jointly issued a final rule (“Rule”) on December 22, 2009, to implement the requirements of Section 615(h) of the federal Fair Credit Reporting Act (“FCRA”). Section 615(h) of the FCRA was added by the FACT Act, and provides for so-called “risk-based pricing” notices (“RBP Notices”). The effective date of the Rule is January 1, 2011.

The Rule provides a general requirement describing when a creditor must provide an RBP Notice to a consumer, and provides several alternative methods a creditor may use to determine whether an RBP Notice is required. The Rule

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also describes several exceptions to the RBP Notice requirement, including if the creditor provides certain credit score information to applicants.

For those entities subject to the FTC's jurisdiction, the Rule will be enforced administratively by the FTC under the FTC Act, pursuant to Section 621(a) of the FCRA. The Rule will be enforced administratively by the federal banking agencies under Section 8 of the Federal Deposit Insurance Act, pursuant to Section 621(b) of the FCRA. There are no federal private rights of action available to enforce the requirements of the Rule.

GENERAL REQUIREMENT

The Rule generally applies to any person who: (i) uses a consumer report in connection with credit that is primarily for personal, family, or household purposes; and (ii) based in whole or in part on the consumer report, provides credit on "material terms" that are "materially less favorable" than the "most favorable terms" available to "a substantial proportion" of consumers from or through that person. In such circumstances, the person must provide the consumer an RBP Notice unless an exception applies.

In most circumstances, the Rule defines "material terms" to be the annual percentage rate ("APR") applicable to the loan in question. For open-end credit (other than credit cards), it would be the APR disclosed in account opening disclosures, excluding any temporary initial rate and any penalty rate. For a credit card (other than one used to access a home equity line of credit), it is the purchase APR. For closed-end credit, it is the APR disclosed prior to consummation. For credit for which there is no APR (*e.g.*, a wireless phone plan or a charge card account), the material term is the financial term that varies based on information in a consumer report and that has the most significant financial impact on consumers, such as a deposit required in connection with credit extended by a telephone company or utility or an annual membership fee for a charge card.

The Rule defines a material term to be "materially less favorable" if the term(s) extended to a consumer differ from the terms extended to another consumer from or through the same person such that the cost of credit to the first consumer would be significantly greater than the cost of credit to the other consumer.

APPLICATION OF THE REQUIREMENT: DIRECT COMPARISON

A person may make a determination as to whether a consumer must receive an RBP Notice by directly comparing the material terms offered to each consumer and the material terms offered to other consumers for a specific type of credit product. For purposes of the Rule, a “specific type of credit product” means one or more credit products with similar features that are designed for similar purposes. Examples of a specific type of credit product include student loans, unsecured credit cards, secured credit cards, new automobile loans, used automobile loans, fixed-rate mortgage loans, and variable-rate mortgage loans.

APPLICATION OF THE REQUIREMENT: CREDIT SCORE PROXY

A person that sets the material terms of credit based in whole or in part on a credit score may comply with the Rule by providing an RBP Notice to each consumer whose credit score is below the “cutoff score.” The “cutoff score” is the point at which approximately 40 percent of a person’s consumers have higher credit scores and approximately 60 percent of its consumers have lower credit scores. A person that generally uses two or more credit scores in setting the material terms of credit granted to a consumer must determine the appropriate cutoff score using the same method the person uses to evaluate multiple scores when making credit decisions.

In the case of credit that has been provided on the most favorable credit terms to more than 40 percent of consumers, a person may, at its option, set its cutoff score at a point at which the approximate percentage of consumers who historically have been granted material terms other than the most favorable terms would receive RBP Notices under the Rule.

APPLICATION OF THE REQUIREMENT: TIERED PRICING

A person that sets the material terms of credit by placing the consumer within one of a discrete number of pricing tiers, based in whole or in part on a consumer report, may comply by providing an RBP Notice to each consumer who is not placed within the top pricing tier or tiers.

APPLICATION OF THE REQUIREMENT: CREDIT CARDS

The Rule provides an additional alternative that credit card issuers may use. A credit card issuer may provide an RBP Notice if a consumer applies for a credit card to which more than a single possible purchase APR may apply and, based in whole or in part on a consumer report, the card issuer provides a credit card to the consumer with a purchase APR that is greater than the lowest purchase APR available through that application or solicitation.

CONSISTENCY REQUIRED FOR USE OF ALTERNATIVES

The Agencies make clear that if a creditor uses one of the alternative methods for compliance (*i.e.*, credit score, tiered pricing, or credit card), the person must use the same method to evaluate consumers who are granted a specific type of credit product.

ACCOUNT REVIEW

A person must provide an RBP Notice if the person uses a consumer report in connection with a review of credit that has been extended to the consumer and, based in whole or in part on the consumer report, increases the APR (or, in the case of a credit card, the purchase APR).

RBP NOTICE CONTENTS, FORMAT, TIMING

Among other things, the RBP Notice must include a description of a consumer report, a statement that the terms offered to that consumer are based on the consumer report, and that the terms may be less favorable than the terms offered to consumers with better credit histories. The RBP Notice must also identify the name and contact information of the consumer reporting agency that provided the consumer report. The RBP Notice must be clear and conspicuous and provided to the consumer in oral, written, or electronic form.

In the case of closed-end credit, the creditor must provide the RBP Notice before the consummation of the transaction, but not earlier than the time the decision to approve the provision of credit is communicated to the consumer

by the person required to provide the notice. In the case of open-end credit, the creditor must provide it before the first transaction is made under the plan, but not earlier than the time the decision to approve the provision of credit is communicated to the consumer by the person required to provide the notice. In the case of an account review, the creditor must provide it at the time the decision to increase the APR (purchase APR in the case of a credit card) is communicated to the consumer by the person required to provide the notice, or if no notice of the increase in the APR is provided to the consumer prior to the effective date of the change in APR (to the extent permitted by law), no later than five days after the effective date of the change in APR.

DIRECT AUTO LENDING VARIATION

If a person to whom a credit obligation is initially payable grants, extends, or provides credit to a consumer for the purpose of financing the purchase of an automobile from an auto dealer or other party that is not affiliated with the person, any requirement to provide an RBP Notice is satisfied if the person provides the RBP notice (or notice pursuant to an exception), or arranges to have the auto dealer or other party provide such notice, and maintains reasonable policies and procedures to verify that such party provides such notice to the consumer.

INSTANT CREDIT VARIATION

If open-end credit is granted to a consumer in person or over the telephone for the purpose of financing the contemporaneous purchase of goods or services, any RBP Notice may be provided at the earlier of the time of the first mailing by the person to the consumer after the decision is made to grant the credit, such as in a mailing containing the account agreement or credit card, or within 30 days after the decision to approve the credit. This flexibility is not provided for Internet transactions.

EXCEPTIONS: GENERAL

A person is not required to provide an RBP Notice if the consumer ap-

plies for specific material terms and is granted those terms, unless those terms were specified by the person using the consumer report after the consumer applied for or requested credit and after the person obtained the consumer report. A person is also not required to provide an RBP Notice if the person has provided or will provide an adverse action notice to the consumer pursuant to Section 615(a) of the FCRA.

EXCEPTIONS: CREDIT SCORE DISCLOSURES

A person is not required to provide an RBP Notice if the person provides to the applicant(s) (regardless of whether credit was approved) a credit score disclosure notice (“Credit Score Notice”). Although there are slight variations between Credit Score Notice requirements for residential mortgage credit and other types of credit, the requirements are generally similar. The Rule specifies the information to be included in the Credit Score Notice, including a description of a consumer report, a description of a credit score, credit score distribution information, and a credit score (which, depending on the circumstances, may need to be the credit score used in the transaction). Generally, the Credit Score Notice must be clear and conspicuous and segregated from other information provided to the consumer. It must also be in writing and in a form the consumer may keep. The Credit Score Notice must be provided to the consumer as soon as reasonably practicable after the credit score has been obtained, but in any event at or before consummation of a transaction in the case of closed-end credit or before the first transaction is made under an open-end credit plan.