

Banking - USA

Federal Reserve and Federal Trade Commission Issue Risk-Based Pricing Notice Rule

January 22 2010

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Risk-Based Pricing Notice Rule

On December 22 2009 the Board of Governors of the Federal Reserve System and the Federal Trade Commission (FTC) jointly issued a final rule to implement the requirements of Section 615(h) of the federal Fair Credit Reporting Act. Section 615(h) was added by the Fair and Accurate Credit Transactions Act and provides for so-called 'risk-based pricing' (RBP) notices. The rule will come into effect on January 1 2011.

The rule sets out a general requirement whereby a creditor must provide an RBP notice to a consumer, as well as several alternative methods that a creditor may use to determine whether an RBP notice is required. The rule also describes several exceptions to the RBP notice requirement, including where the creditor provides certain credit score information to applicants.

For entities that are 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 Fair Credit Reporting Act. 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 Fair Credit Reporting Act. No federal private rights of action are available to enforce the requirements of the rule.

General Requirements

The rule generally applies to any person that: (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 favourable than the most favourable terms available to a substantial proportion of consumers from or through that person. In such circumstances the person must provide the consumer with an RBP notice unless an exception applies.

In most circumstances the rule defines 'material terms' as the annual percentage rate (APR) applicable to the loan in question. For open-end credit (other than credit cards), it is 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 (eg, a wireless phone plan or charge card account), the material term is the financial term which varies based on information in a consumer report and which has the most significant financial impact on consumers, such as a deposit required in connection with credit extended by a telephone or utility company, or an annual membership fee for a charge card.

The rule identifies a material term as 'materially less favourable' if terms that are extended from or through the same person differ from consumer to consumer so that the cost of credit for one consumer would be significantly greater than the cost for another.

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Application of the Requirement

Direct comparison

A person may determine whether a consumer should receive an RBP notice by directly comparing the material terms offered to each consumer with those offered to other consumers for a specific type of credit product. For the purpose of the rule, a 'specific type' of credit product is one or more credit products with similar features that are designed for similar purposes. Examples of specific types of credit product include student loans, unsecured credit cards, secured credit cards, new car loans, used car loans, fixed-rate mortgage loans and variable-rate mortgage loans.

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 cut-off score. The 'cut-off' score is the point at which approximately 40% of consumers have a higher credit score and approximately 60% have a lower credit score. A person that generally uses two or more credit scores in setting the material terms of credit that is granted to a consumer must determine the appropriate cut-off score using the same method as to evaluate multiple scores when making credit decisions.

In the case of credit that has been provided on the most favourable credit terms to more than 40% of consumers, a person may set its cut-off score at a point at which the approximate percentage of consumers that have historically been granted material terms other than the most favourable terms would receive RBP notices under the rule.

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 that is not placed within the top pricing tier or tiers.

Credit cards

The rule provides an additional alternative for credit card issuers. 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 with a purchase APR that is greater than the lowest purchase APR available through that application or solicitation.

Alternatives

The Federal Reserve System and the Federal Trade Commission make clear that if a creditor uses one of the alternative methods for compliance (ie, credit score, tiered pricing or credit card), the person must use the same method to evaluate consumers that are granted a specific type of credit product.

Account Review

A person must provide an RBP notice if it 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 and Timing

Among other things, the RBP notice must include a description of a consumer report and statements clarifying that (i) the terms offered to the consumer are based on the consumer report, and (ii) the terms may be less favourable than those offered to consumers with better credit histories. The RBP notice must also state the name and contact information of the 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 at which the decision to approve 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 this before the first transaction is made under the plan, but not earlier than the time at which the decision to approve 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 the notice at the time at which 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 which 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 a dealer or other party that is not affiliated with that 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: (i) at 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 (ii) within 30 days of the decision to approve the credit, whichever is the sooner. This flexibility is not afforded to internet transactions.

Exceptions

A person is not required to provide an RBP notice if the consumer applies for specific material terms and is granted those terms, unless the 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 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 Fair Credit Reporting Act.

Regardless of whether credit was approved, a person is not required to provide an RBP notice if it provides the applicant or applicants with a credit score disclosure 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 sets out 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 that was used in the transaction).

The credit score notice must be clear and conspicuous and segregated from other information provided to the consumer. It must also be in writing, in a form that the consumer can keep. The credit score notice must be provided to the consumer as soon as reasonably practicable after the credit score has been obtained, but upon 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.

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