

RISK-BASED PRICING NOTICE



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COMPLIANCE ↘

Scope of Presentation and Materials

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WHY is there a new requirement?

Scenario #1 FCRA helps consumer

- Error negatively affecting consumer's credit report
- Consumer doesn't know about error
- Consumer applies for a car loan
- Because of credit report error dealer turns down credit application
- Consumer receives a FCRA denial notice
- Consumer investigates why denied and discovers error in credit report
- Consumer follows FCRA process to correct error
- Ultimately, consumer applies for and gets car loan on appropriate terms

WHY is there a new requirement? (cont.)

Scenario #2 FCRA does not help consumer

- Error negatively affecting consumer's credit report
- Consumer doesn't know about error
- Consumer applies for a car loan
- Because of credit report error dealer offers consumer credit sale *with higher interest rate and charges*
- Consumer agrees to credit sale at higher rate and buys car
- Consumer never finds out about credit report error – unnecessarily pays more for credit
- FCRA did not help consumer discover error and avoid higher costs

WHY is there a new requirement? (cont.)

Purpose of the new risk-based pricing notice requirement is to help address situations like Scenario #2

Fair and Accurate Credit Transactions Act (FACT Act) of 2003

(Public Law 108-159, 117 Stat. 1952)

Title III - Enhancing the Accuracy of Consumer Report Information

Section 311 Risk-based Pricing Notice

Implementing regulations published Jan. 15, 2010. (75 Federal Register 2724 to 2784)

The risk-based pricing notice will alert consumers when they are getting different terms than others based on credit information. Before the FCRA only required a denial notice, so consumer was alerted to credit report problems if credit application is denied. But nothing in FCRA to alert customer who receives credit on less favorable terms that there might be credit report errors or inaccuracies creating problems.

The risk-based pricing notice is intended as a substitute for the adverse action notice in the FCRA when consumer isn't denied credit but is paying a higher price for it. (See 75 FR 2730)

WHAT is required?

A new risk-based pricing notice is required to be given by all persons that use credit reports to make a credit decision. This includes auto dealers (the notice must be given by the person to whom the obligation is initially payable – the original creditor).

“The final results generally require a creditor to provide a risk-based pricing notice to a consumer when the creditor uses a consumer report to grant or extend credit to the consumer on material terms (APR for closed-end credit) that are materially less favorable* than the most favorable terms available to a substantial proportion of consumer from or through that creditor.” ((75 FR 2724))

* “materially less favorable” that the material terms granted, extended or otherwise provided to a consumer differ from the terms granted, extended, or otherwise provided 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 granted, extended or otherwise provided to the other consumer. 16 C.F.R. § 640.2(o)

WHO ...

- **Who created this requirement?**

Congress created the notice requirement in Section 311 of the FACT Act (15 USC 1681m(h)).

Section 311 requirements of the FACT Act required implementing regulations to define and detail the requirements. The Federal Reserve Board and the Federal Trade Commission promulgated the regulations.

- **Who does it apply to (who must give the notice)?**

All persons that use credit reports to make a credit decision – and who offer different credit terms based on the credit report information.

- **Who must receive the notice?**

Consumers applying for consumer purpose credit – but only those who are not receiving the most favorable credit terms (more detail to follow).

WHEN is compliance required?

The effective date to begin providing risk-based pricing notices is January 1, 2011.

HOW do I comply?

Beware: It will take a bit of effort to sort through the notice options. Do not wait until December 31, 2010 to begin planning your compliance.

First Step. Determine if you really need to give a notice.

- A notice is required if ...

Except as otherwise provided, a person must provide to a consumer a notice (“risk-based pricing notice”) in the form and manner required if the person both –

- Uses a **consumer report** in connection with an application for, or a grant, extension, or other provision of, credit to that consumer that is primarily for person, family, or household purposes; and
- Based in whole or in part on the consumer report, grants, extends, or otherwise provided credit to that consumer on **material terms** that are **materially less favorable** than the most favorable material terms available to a **substantial proportion of consumers** from or through that person.

16 CFR § 640.3(a)

Note:

Dealers must give the notice even if they immediately assign the paper. 16 CFR § 640.6(b)(1))

The purchaser or assignee does not need to give the notice. 16 CFR § 640.6(b)(2)

Bank doing direct loan to consumer who will use proceeds to buy a motor vehicle must give the notice. If dealer and bank make arrangements for dealer to provide the notice, then bank can satisfy this requirement by having dealer (as agent for bank) provide the notice

Exceptions. No notice of any kind is required if ...

- You offer credit on the same terms to every approved applicant (i.e., you do not offer varying terms depending on applicant's credit report)
- You don't use credit reports in any way to make the credit decision
- The transaction is not for a consumer purpose. The requirement only applies to consumer purpose transactions (personal, family, or household purpose) – not commercial
- The transaction is a consumer lease. (see 75 FR 2727)
- The terms offered to applicant are your most favorable rates and charges. The notice is for those receiving less than the best terms (more detail to follow).
- A guarantor, co-signer, surety, or endorser for another consumer who applies and is approved for credit is not a consumer whom it “grants, extends, or otherwise provides credit” so they are not required to receive the risk-based pricing notice. (see 75 FR 2731)

Other “exceptions” under 16 CFR § 640.5:

- **Application for specific terms.** Creditor does not need to provide a risk-based pricing notice if – Consumer applies for specific material terms and is granted those terms, unless those terms were specified by the creditor using a consumer report after the consumer applied for credit (16 CFR § 640.5(a)(1))
- **Adverse action notice provided.** Creditor does not need to provide a risk-based pricing notice if it provides consumer an adverse action notice. (16 CFR § 640.5(b))
- **Prescreened solicitations.** Creditor does not need to provide a risk-based pricing notice if – Creditor provides a firm offer of credit terms based on a consumer report that is a prescreened list described in FCRA section 604(c)(2). (16 CFR § 640.5(c)(1))
- **Credit Score Disclosure.** Creditor does not need to provide a risk-based pricing notice if – Consumer requests credit that is not secured by a one to four units of residential real property *and creditor provides consumer a special notice* (See Model B-4 below) (16 CFR § 640.5(e)(1))
- **Credit Score Not Available Disclosure.** Creditor does not need to provide a risk-based pricing notice if – Creditor regularly obtains credit scores from a consumer reporting agency and provides credit score disclosures to consumers, but a credit score is not available from the consumer reporting agency regularly used by creditor and creditor does not get one from another consumer reporting agency, *and creditor provides consumer a special notice* (See Model B-5 below) (16 CFR § 640.5(f)(1))

Second Step. If you are “materially” confused by the requirements, take another look at whether the notice is required.

- **Consumer Report used. See FCRA definition (15 U.S.C. 1681a(d))**
- **Credit is for Consumer Purpose. Primarily for personal, family or household purposes**
- **(There is not an objective standard for determining whether material terms are materially less favorable.)**
- **Credit granted on “material terms” ... – meaning the annual percentage rate required to be disclosed under Reg. Z (12 CFR § 226.17(c) and 226.18(e)) for closed-end credit transactions**
- **... that are “materially less favorable” than the most favorable terms available ... – means the terms offered to one consumer would be significantly greater than the cost of credit provided to another consumer. Factors relevant to determining the significance of a difference in cost include the type of credit product, the term of the credit extension, the extent of the difference between the materials terms provided to different consumers.**
- **... to a “substantial proportion” of consumers from or through that person – “Substantial proportion of consumers” is not defined because the regulating agencies believe that no definition could reflect the widely varying pricing practices of creditors. “While each creditor’s ‘substantial proportion’ determination is an individual decision, the Agencies expect that creditors will consider ‘a substantial proportion’ as constituting more than a de minimis percentage, but that may or may not represent a majority. (75 FR 2730)**

16 CFR § 640.3(o)

Third Step. If you are *still* confused, use one of the three methods provided by the FTC to determine which consumers must receive a notice.

16 CFR § 640.3(b) provides three options for how to determine which consumers must receive a notice:

 **Direct Comparison Method (case-by-case). 16 CFR § 640.3(b)**

 **Credit Score Proxy Method. 16 CFR § 640.3(b)(1)**

 **Tiered Pricing Method. 16 CFR § 640.3(b)(2)**

Methods to determine which customers receive a notice...

(1) Direct Comparison Method (case-by-case). 16 CFR § 640.3(b).

Directly compare the material terms offered to each consumer and the material terms offered to other consumers for a specific type of credit product.

The Agencies did not create a quantitative standard or specific methodology for determining whether a consumer is receiving materially less favorable terms.

As part of this analysis, creditor needs to identify the appropriate subset of its current or past consumers to compare to any given consumer.

If using this method to evaluate consumers who obtain credit to finance the purchase of used automobiles, then creditor must use the same method for all such consumers for used automobile credit transactions. The same creditor could use different analysis method for other specific types of credit products.

Methods to determine which customers receive a notice...

(2) Credit Score Proxy Method. 16 CFR § 640.3(b)(1)

This method substitutes a comparison of the credit scores of different consumers as a proxy for a comparison of the material terms offered to different consumers (thus the name “Credit Score Proxy Method”)

This method is focused on a single variable: the consumer’s credit score.

If creditor sets the material terms of credit provided to a consumer based in whole or in part on the credit score, it can satisfy the notice requirement by providing the notice to those consumers whose credit scores are in the bottom 60% of accepted consumer applicants.

Using this method, creditor does not have to consider the actual credit terms offered to each consumer. Creditor only compares the credit score of a given consumer with the pre-calculated cutoff score to determine if a notice is required.

Creditor can determine and use its own cutoff point based on its own historical experience (or market data in limited cases) *as long as* it has granted, extended, or provided the most favorable material terms to more than 40% of consumers.

Creditor must recalculate its cutoff scores no less than every 2 years. Creditor must recalculate in one year if it used market or third-party data to determine the cutoff.

If using this method and consumer doesn’t have a credit score, then creditor must assume provide a risk-based pricing notice to the consumer. 16 CFR § 640.3(b)(1)(iv)

Methods to determine which customers receive a notice...

(3) Tiered Pricing Method. 16 CFR § 640.3(b)(2)

A creditor that sets the material terms of credit provided to a consumer by placing the consumer in one of a discrete number of pricing tiers for a specific type of credit product, based in whole or in part on a consumer report, many comply with the risk-based pricing notice requirements by providing a notice to each consumer who is not placed in the top pricing tier (if four or fewer tiers).









If creditor uses five or more tiers, the notice must be given to each consumer who is not placed in the top two tiers plus any other tiers that together make up no less than the top 30% but not more than the top 40% of the total number of tiers. Example, if creditor has 9 tiers, the number of tiers in the top 30% but not more than top 40% of the number of tiers = 3. So creditor must give the risk-based pricing notice to consumers in the bottom 6 pricing tiers.

The requirements include additional methods described for credit card programs and changes in pricing after inception due in whole or in part to changes in the consumer's credit report (account review). They are beyond the scope of this presentation. For more information see 16 CFR § 640.3(c) and (d).

Fourth Step. Determine Notice Content, Delivery Format, and Timing of Delivery – of Risk-Based Pricing Notice.

Content of risk-based pricing notice –

Risk-Based Pricing Notice must include:

-  A statement that a consumer report or credit report includes information about consumer's credit history and the type of information included in that history
-  A statement that the terms offered, such as the annual percentage rate, have been set based on information from a consumer report
-  A statement that the terms offered may be less favorable than the terms offered to consumers with better credit histories
-  A statement that the consumer is encouraged to verify the accuracy of the information contained in the consumer report and has the right to dispute any inaccurate information in the report
-  The identity of each consumer reporting agency that furnished a consumer report used in the credit decision
-  A statement that federal law gives the consumer the right to obtain a copy of a consumer report from the consumer reporting agency or agencies identified in the notice without charge for 60 days after receipt of the notice
-  A statement informing the consumer how to obtain a consumer report from the consumer reporting agency or agencies identified in the notice and providing contact information (including a toll-free telephone number, where applicable) specified by the consumer reporting agency or agencies; and
-  A statement directing consumers to the Web sites of the FRB and FTC to obtaining more information about consumer reports.

16 CFR § 640.4(a)(1)

Different content for an account review

See 16 CFR § 640.4(a)(2)

Delivery Format / Form of Notice –

The Notice must be clear and conspicuous and provided in oral, written or electronic form.

Separate form not specifically required, but is probably the best idea.

Use of the FTC's Model Form is optional - but use of the appropriate model form completed correctly is deemed to comply with the content and form requirements (safe harbor for compliance)

Creditor may change the forms by rearranging the format or by making technical modifications to the language of the forms, in each case without modifying the substance of the disclosures. But can't change to such an extent that it materially affects the substance, clarity, comprehensibility, or meaningful sequence of the forms. Change too much and you lose the safe harbor protection.

75 FR 2776, Appendix B

When risk-based pricing notice is given, each consumer must receive a notice when credit involves more than one borrower/buyer. If consumers have the same address, creditor can give one notice to those with a common address. 16 CFR § 640.6(c)(1)

Timing of notice – closed end / after approval decision but before consummation of transaction

Separate timing rules apply for open-end credit and account reviews (changes after consummation)

Timing and delivery in certain automobile lending transactions

See 16 CFR § 640.4(c)(2)

If third party creditor arranges for dealer to do the paperwork, it can also arrange to have the dealer prepare and deliver the risk-based pricing notice on its behalf within the required time frames, but it must also maintain reasonable policies and procedures to verify that the dealer provides the notice to the consumer within the applicable time periods.

If the B-4 notice (the credit score disclosure exception) is given, the dealer's credit score can be used if it doesn't know the credit score the creditor will use.



Acceptable changes to Model forms include:

- Correcting or updating telephone numbers, mailing addresses, web site addresses
- Adding graphics or icons, such as creditor's logo
- Alteration of the shading or color used in the model forms
- Use of a different form of graphical presentation to depict the distribution of credit scores.
- Substituting words "credit" and "creditor" or "finance" and "finance company" for the terms "loan" and "lender"
- Using a pre-printed list of sources of consumer reports or consumer reporting agencies in a checkbox format
- Including the name of the consumer, transaction identification, date, and other information that will assist in identifying the transaction to which the form pertains
- Including the name of an agent, such as an auto dealer or other party, when providing the "Name of the Entity Providing the Notice"

Changes to Model that are NOT acceptable include:

- Providing model forms on register receipts or interspersed with other disclosures
- Removing empty lines and extra spaces between sentences within the same section

Appendix B, see 75 FR 2776

Fifth Step – Part A. Consider Alternative to Risk-Based Pricing Notice

Exceptions allow providing other forms instead of the Model B-1 Risk-Based Pricing Notice.

■ CREDIT SCORE DISCLOSURE (Model B-4)

Creditor does not need to provide a risk-based pricing notice if – Consumer requests credit that is not secured a one to four units of residential real property *and creditor provides consumer a special notice* (See Model B-4 below) (16 CFR § 640.5(e)(1))

If creditor uses this exception, it must provide the notice to any consumer who requests credit in connection with loans that are not secured by real property and for which the creditor uses risk-based pricing, without performing a comparison of the terms offered to different consumers! (Creditors do not need to use this exception if one of the other exceptions applies – i.e., if another exception says a risk-based pricing disclosure is not required at all).

The Credit Score Disclosure notice must contain a list of 12 items of information:

- A statement that a consumer report (or credit report) is a record of the consumer's credit history and includes information about whether the consumer pays his or her obligations on time and how much the consumer owes to creditors
- A statement that a credit score is number that takes into account information in a consumer report and that a credit score can change over time to reflect changes in the consumer's credit history
- A statement that the consumer's credit score can affect whether the consumer can obtain credit and what the cost of that credit will be
- The current credit score of the consumer or the most recent credit score of the consumer that was previously calculated by the consumer reporting agency for a purpose related to the extension of credit
- The range of possible credit scores under the model used to generate the credit score

The Credit Score Disclosure notice must contain a list of 12 items of information (cont):

- The distribution of credit scores among consumers who are scored under the same scoring model that is used to generate the consumer's credit score using the same scale as that of the credit score that is provided to the consumer, presented in bar graph form containing at least 6 bars, illustrating the percentage of consumers with credit scores within the range of scores reflected in each bar, or by other clear and readily understandable graphical means, or a clear and readily understandable statement informing the consumer how his or her credit score compares to the scores of other consumers. (Use of a graph or statement obtained from the person providing the credit score is acceptable.)
- The date on which the credit score was created
- The name of the consumer reporting agency or other person that provided the credit score
- A statement that the consumer is encouraged to verify the accuracy of the information contained in the consumer report and has the right to dispute any inaccurate information in the report
- A statement that federal law gives the consumer the right to obtain copies of his or her consumer reports directly from the consumer reporting agencies, included a free report from each of the nationwide consumer reporting agencies once during any 12-month period
- Contact information for the centralized source from which consumer may obtain their free annual consumer reports, and
- A statement directing consumer to the web sites of the FRB and FTC to obtain more information about consumer reports

Additional form-of-notice requirements for the exception notice –

- Notice must be clear and conspicuous and
- Segregated from other information provided to consumer, and
- Provided in writing in a form the customer can keep

Timing of the exception notice – closed end / as soon as reasonably practicable after credit score is obtained but in any event at or before consummation of transaction

If the Credit Score Disclosure notice is used, it must be given to each consumer even if they have the same address. Each consumer must receive a notice with his/her credit score and not the score of the other consumer(s). 16 CFR § 640.6(c)(2)

Separate timing rules apply for open-end credit and account reviews (changes after consummation)

Appropriate use of the Model Form (B-4) is a safe harbor.





Fifth Step – Part B. Consider Alternative to Risk-Based Pricing Notice

Exceptions allow providing other forms instead of the Model B-1 Risk-Based Pricing Notice.

■ CREDIT SCORE NOT AVAILABLE DISCLOSURE (Model B-5)

Creditor does not need to provide a risk-based pricing notice if – creditor regularly obtains credit scores from a consumer reporting agency and provides credit score disclosures to consumers, but a credit score is not available from the consumer reporting agency regularly used by creditor and creditor does not get one from another consumer reporting agency, *and creditor provides consumer a special notice* (See Model B-5) (16 CFR § 640.5(f)(1))

The Credit Score Not Available Disclosure must contain a list of 9 items of information:

- A statement that a consumer report (or credit report) includes information about the consumer's credit history and the type of information included in that history
- A statement that a credit score is number that takes into account information in a consumer report and that a credit score can change over time in response to changes in the consumer's credit history
- A statement that the consumer's credit scores are important because consumers with higher credit scores generally obtain more favorable credit terms
- A statement that not having a credit score can affect whether the consumer can obtain credit and what the cost of that credit will be

The Credit Score Not Available Disclosure must contain a list of 9 items of information (cont.):

- **A statement that a credit score about the consumer was not available from a consumer reporting agency, which must be identified by name, generally due to insufficient information regarding the consumer's credit history**
- **A statement that the consumer is encouraged to verify the accuracy of the information contained in the consumer report and has the right to dispute any inaccurate information in the consumer report**
- **A statement that federal law gives the consumer the right to obtain copies of his or her consumer reports directly from the consumer reporting agencies, included a free report from each of the nationwide consumer reporting agencies once during any 12-month period**
- **Contact information for the centralized source from which consumers may obtain their free annual consumer reports, and**
- **A statement directing consumers to the web sites of the FRB and FTC to obtain more information about consumer reports**

Additional form of notice requirements for the exception notice

- Notice must be clear and conspicuous and
- Segregated from other information provided to consumer, and
- Provided in writing in a form the customer can keep

Timing of notice – closed end / as soon as reasonably practicable after credit score is obtained but in any event at or before consummation of transaction

If the Credit Score Not Available Disclosure is used, it must be given to each consumer even if they have the same address. Each consumer must receive a notice with his/her credit score and not the score of the other consumer(s). 16 CFR § 640.6(c)(2)

Separate timing rules apply for open-end credit and account reviews (changes after consummation)

Appropriate use of the Model Form (B-5) is a safe harbor.



Enforcement

With respect to auto dealers, the provisions of the risk-based pricing rules will be enforced under the authority of sections 621(a) and (b) of the Fair Credit Reporting Act (15 USC §1681s(a) and (b)) which provides that the FTC shall enforce under the authority of the Federal Trade Commission Act (15 USC § 41 et seq.).

- Any person violating any of the provisions of the FCRA are subject to the penalties and entitled to the privileges and immunities provided in the Federal Trade Commission Act as though the applicable terms and provisions thereof were part of the FCRA.
- In the event of a knowing violation, which constitutes a pattern or practice of violations of the FCRA, the FTC may commence a civil action to recover a civil penalty in a district court of the United States against any person that violates the FCRA. In such action, such person shall be liable for a civil penalty of not more than \$ 2,500 per violation.
- In determining the amount of a civil penalty under subparagraph (A), the court shall take into account the degree of culpability, any history of prior such conduct, ability to pay, effect on ability to continue to do business, and such other matters as justice may require.
- There is no private right of action under the rules. So consumers cannot initiate a claim against a creditor for failing to comply with the rule.

BEWARE:

This doesn't mean a creditor won't be sued by consumers under other legal theories if consumer believes he or she has suffered a loss because of creditor's non-compliance with the risk-based pricing notice requirements



Questions?