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Fair Credit Reporting Act Risk-Based Pricing Regulations Update

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On July 6, 2011, the Federal Reserve Board (FRB) and Federal Trade Commission (FTC) published a final rule adding requirements to the Fair Credit Reporting Act (FCRA) Risk-Based Pricing regulations which were effective January 1, 2011. This article highlights the new requirements implemented in accordance with the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) and reviews FCRA risk-based pricing notice (RBPN) requirements which continue to generate questions.

Pursuant to the FCRA, a consumer must receive a RBPN if a consumer report is used in connection with an application, grant, extension or other provision of credit and, based in whole or in part on the consumer report, the credit is granted, extended, or provided on material terms that are materially less favorable than the most favorable terms available to a substantial proportion of consumers.

The form, content, timing and manner of delivery of the required RBPN were addressed by the FRB and FTC in early 2010. That first rulemaking provided two alternative means by which mortgage lenders may determine when they are engaged in risk-based pricing. For the purposes of this discussion, let us assume the creditor engages in risk-based pricing, defined as the practice of setting the price and/or other terms of credit offered to a particular consumer to reflect the risk of nonpayment by that consumer.

As required by Dodd-Frank, the rule published last week requires creditors to include additional disclosures in the RBPN if a consumer's credit score is used in setting the material terms of credit.

Below are key points regarding the RBPN requirements generally, the newly required additional disclosures, and the exception to the general rule for loans secured by residential real property if a proper Credit Score Disclosure Exception Notice is provided to all applicants. Additional RBPN requirements for credit card issuers are not addressed in this article.

Risk Based Pricing Notice

When Notice is Required

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The RBPB must be provided if a person uses a consumer report in connection with credit primarily for personal, family, or household purposes; and, based in whole or in part on the consumer report, provides credit to that consumer on material terms that are materially less favorable than the most favorable terms available to a substantial proportion of consumers.

Determining which Consumers Must Receive the Notice

In order to determine which consumers have received credit on material terms that are materially less favorable than the most favorable terms available to a substantial proportion of consumers, and therefore must receive a RBPB, creditors may utilize one of the following methods:

Case by Case Basis

This method requires creditors to compare material terms offered to each consumer and the material terms offered to other consumers for a specific type of credit product.

Credit Score Proxy

This method requires creditors to determine the credit score that represents the point at which approximately 40% of the consumers to whom it grants, extends or provides credit have higher credit scores and approximately 60% of the consumers to whom it grants, extends or provides credit have lower credit scores, and provide a notice to each consumer to whom it grants, extends or provides credit whose credit score is lower than the cutoff.

Tiered Pricing

Creditors who place consumers within one of a discrete number of pricing tiers for a specific type of credit product, must provide a risk-based

pricing notice to each consumer who is not placed within the top pricing tier or tiers (if four or fewer tiers, all who do not qualify for placement in top tier - i.e. lowest price); if five or more tiers, all who do not qualify for placement in top two tiers.

Content

Model forms are located in the appendix of the FCRA, the use of which provides a safe harbor for compliance. The RBPB must include eight specific statements providing information about consumer reports, the practice of risk-based pricing and certain consumer rights. For the complete list of requirements see Regulation Z, 12 CFR § 222.73(a) (1) (i-viii). Model Form H-1 contains this required information. Use of this model RBPB is appropriate when no consumer credit score is used to set the material terms of credit.

The most recent rulemaking requires the RBPB contain the following additional content if a consumer's credit score is used in setting the material terms of credit:

- The credit score used by the person in making the credit decision;
- The range of possible credit scores under the model used to generate the credit score;
- All of the key factors that adversely affected the credit score, which shall not exceed four key factors, except that if one of the key factors is the number of enquiries made with respect to the consumer report, the number of key factors shall not exceed five;
- 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 a credit score is a 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.

For the purposes of this rule, a "credit score" includes a propriety score developed by creditors if the score is used to predict the likelihood of certain credit behaviors, including default. Some propriety scores, such as insurance scores or scores used to predict the likelihood of false identity are excluded from the definition of "credit score."

A new Model Form H-6 has been provided, the use of which provides a safe harbor for compliance. This form contains the additional credit-score related disclosures which must now be included with the original RBPN content in cases where a consumer's credit score was used to set the material terms of credit.

When the RBPN is Not Required

The RBPN need not be provided if the consumer applies for specific material terms and is granted those material terms, or if the consumer is provided with an adverse action notice. In addition, an exception exists for loans secured by residential real property as described in the following section.

Credit Score Disclosure Exception Notice for Credit Secured by Residential Real Property

In lieu of providing the RBPN to some consumers as set forth above, for credit that is or will be secured by one to four units of residential real property, the creditor may opt to provide an exception notice to every consumer requesting a product for which the creditor uses risk-based pricing, even if the consumer would not otherwise receive a risk-based pricing notice. The notice contains supplemental information which must be provided on or with the Credit Score Disclosure already required by the Fair and Accurate Credit Transactions Act (FACTA).

When Consumers Must Receive the Exception Notice

The Credit Score Disclosure Exception Notice must be provided at the same time as the Credit Score information and Notice to Home Loan Applicant already required by the FACTA (as soon as reasonably practicable).

Content

The exception notice provided on or with the Credit Score Disclosure must include, among other items, the following information:

- A consumer report is a record of the consumer's credit history;
- A credit score is a number that takes into account information in a consumer report;
- A credit score can affect whether the consumer can obtain credit and what the cost of that credit will be;
- A distribution of credit scores among consumers who are scored under the same scoring model that is used to generate the consumer's credit score, in the form of a bar graph meeting certain specifications, or a clear statement informing the consumer how his or her credit score compares to the scores of other consumers;
- A consumer is encouraged to verify the accuracy of the information contained in the consumer report;
- Federal law gives the consumer the right to obtain copies of his or her consumer report directly from the consumer reporting agencies;
- Contact information for the centralized source from which consumers may obtain their free annual consumer report; and

- Web sites of the Federal Reserve Board and the Federal Trade Commission for more information about consumer reports.

Model Form H-3 contains the required language for the Credit Score Disclosure Exception notice. The most recent rulemaking did not change the timing or content of this notice.

The July 6, 2011 rule and new model forms are available at:

<http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20110706a1.pdf>

The original RBPB rules and the model form Credit Score Disclosure Exception notice are available at:

<http://edocket.access.gpo.gov/2010/pdf/E9-30678.pdf>