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## Fair Credit Reporting Act Update: FTC And FRB Issue Proposed Regulations Requiring Creditors To Send Risk-Based Pricing Notices

Most people already know that having a good credit history enables them to get better credit terms than people with a bad credit history. To promote that message, the Fair Credit Reporting Act (FCRA) was amended in 2003 to require creditors to inform consumers when a consumer report has adversely impacted the loan terms available to that consumer. 15 U.S.C. § 1681m(h). The FCRA provides little detail about when a risk-based pricing notice must be sent or what it must say. Instead, the statute requires the Federal Trade Commission and the Federal Reserve Board (“the Agencies”) to jointly issue rules describing: (i) when a risk-based pricing notice must be sent; (ii) exceptions to the notice requirement; and, (iii) the form and content of the notice. 15 U.S.C. § 1681m(h)(6).

The Agencies recently issued proposed regulations clarifying the FCRA’s requirements regarding risk-based pricing notices. 73 Fed. Reg. 28966. Anyone wishing to comment on the proposed regulations must do so by August 18, 2008.

### WHEN A RISK-BASED PRICING NOTICE MUST BE SENT

Currently, the FCRA states that a risk-based pricing notice must be sent when, based on a consumer report, a creditor provides credit “on material terms that are materially less favorable than the most favorable terms available to a substantial proportion of” the creditor’s other customers. 15 U.S.C. § 1681m(h)(1). The proposed regulations provide three alternative methods for determining when a notice must be sent: (i) the direct comparison method; (ii) the credit-score proxy method; and (iii) the tiered pricing method.

#### Direct Comparison Method

Under the direct comparison method, a notice must be sent where the material credit terms offered to a consumer are materially less favorable than the most favorable terms offered to a substantial proportion of the creditor’s other

customers. 12 C.F.R. § 222.72(a)(2).<sup>1</sup> “Material terms” is defined as the annual percentage rate (APR), as defined in Regulation Z, the implementing regulation of the Truth in Lending Act. 12 C.F.R. § 222.71(a), (i). If there is no APR, material terms are defined as any other monetary terms that vary based on the consumer report, such as the amount of a down payment or deposit. *Id.*

Material terms are “materially less favorable” where the terms would cause the credit to have a “significantly greater” cost. 12 C.F.R. § 222.71(j). What constitutes a “substantial proportion” of a creditor’s customers is not defined, and the accompanying commentary says only that such a proportion would be “more than a de minimus percentage, but [ ] may or may not represent a majority.” 73 Fed. Reg. 28972. The commentary recognizes that “it may not be feasible or practical for many creditors to make the direct comparisons required by the [direct comparison method].” 73 Fed. Reg. 28974.

#### Credit-Score Proxy Method

The credit-score proxy method requires a creditor to: (i) determine a “cutoff” credit score at which 40 percent of the creditor’s customers have a higher credit score, and 60 percent have a lower credit score; and (ii) provide a risk-based pricing notice to the 60 percent of customers whose credit score is lower than the cutoff. 12 C.F.R. § 222.72(b)(1)(i). The cutoff score is calculated by using the credit scores of “all or a representative sample of the consumers to whom it has granted, extended, or otherwise provided credit for a given class of products, such as mortgages, credit cards, or auto loans.” 12 C.F.R. § 222.72(b)(1)(ii)(A).

The “cutoff score” must be re-calculated at least every two years. 12 C.F.R. § 222.72(b)(1)(ii)(C). Creditors who use the credit-score proxy method and who provide credit to a consumer who does not have a credit score must automat-

ically provide that person with a risk-based pricing notice. 12 C.F.R. § 222.72(b)(1)(iii).

### Tiered Pricing Method

Creditors who place consumers in a “discrete number of pricing tiers” can use the tiered pricing method. 12 C.F.R. § 222.72(b)(2)(i). Under this method, creditors who have four or fewer pricing tiers must send a notice to every consumer who does not qualify for the top tier. 12 C.F.R. § 222.72(b)(2)(ii). Creditors who have more than four pricing tiers must send a notice to every consumer who does not qualify for the top two tiers and any additional tiers that are no less than the top 30 percent and no more than the top 40 percent of the total number of tiers. 12 C.F.R. § 222.72(b)(2)(iii). For example, a creditor with nine pricing tiers must send a risk-based pricing notice to every consumer who does not qualify for the top three tiers because three is not less than 30 percent (2.7) and not more than 40 percent (3.6) of the total number of tiers. *Id.*

### Account Review

The three methods described above apply where credit is initially provided to a consumer. Additionally, the proposed regulations also require that a risk-based pricing notice be sent wherever a creditor raises the APR charged to a consumer based on the information contained in the consumer report. 12 C.F.R. § 222.72(d).

### EXCEPTIONS TO RISK-BASED PRICING NOTICE REQUIREMENT

The proposed regulations create several exceptions to the risk-based pricing notice requirement. Risk-based pricing notices need not be sent to consumers if any of the following circumstances apply:

1. The credit is used for business purposes. Notices need only be sent in connection with credit used for personal,

family, and household purposes. 12 C.F.R. § 222.70(a);

2. The consumer applies for specific credit terms and is granted those terms, unless the terms were first specified by the creditor after the application for credit and based on the consumer report. This exception does not apply, and a notice must still be sent, where a risk-based pricing notice is triggered by an account review. 12 C.F.R. § 222.74(a)(1);

3. The consumer receives an adverse action notice under the FCRA 12 C.F.R. § 222.74(b);

4. The consumer receives credit in connection with a firm offer of credit under the FCRA. 12 C.F.R. § 222.74(c).

Creditors are also not required to send a risk-based pricing notice (unless triggered by an account review) if creditors instead send out one of three model form credit score notices. 12 C.F.R. § 222.74(d), (e), (f); 12 C.F.R. § 222, Appendix H-3, H-4, H-5. These three alternative model forms are similar to the credit score notice already required by the FCRA at 15 U.S.C. § 1681g(g). The three forms can be used, where appropriate, in one of the following circumstances:

1. Where the credit is secured by one to four units of residential real property. 12 C.F.R. § 222.74(d); 12 C.F.R. § 222, Appendix H-3.

2. Where the credit is not secured by residential real property. 12 C.F.R. § 222.74(e); 12 C.F.R. § 222, Appendix H-4.

3. Where the consumer has no credit report. 12 C.F.R. § 222.74(f); 12 C.F.R. § 222, Appendix H-5.

### WHAT A RISK-BASED PRICING NOTICE MUST SAY

The proposed regulations provide a list of the information that a risk-based pricing notice must include. 12 C.F.R. § 222.73(a). The proposed regulations also includes a model form that can be used to comply with the content requirements. 12 C.F.R. § 222, Appendix H-1. The proposed regulations contain different content requirements and a different model form for risk-based pricing notices sent in connection with an account review. *See* 12 C.F.R. § 222.73(a)(2); 12 C.F.R. § 222, Appendix H-2. As mentioned above, different model forms are also provided for creditors who use the alternative credit-score notices. 12 C.F.R. § 222, Appendix H-3, H-4, H-5.

### CONCLUSION

If adopted, the proposed regulations will require creditors send a new notice to consumers under certain circumstances. Creditors have the opportunity to submit comments to the Agency by August 18, 2008 to modify or clarify the requirements of the proposed regulations.

<sup>1</sup> Citations are to 12 C.F.R. §222, as amended by the proposed regulations. The proposed regulations would also make identical amendments to 16 C.F.R. § 640.

### ABOUT THE AUTHORS

Thomas J. Cunningham, P. Russell Perdew, and J. Matthew Goodin represent banks, mortgage lenders, insurance companies and other financial institutions, as well as many other types of business clients, in state and federal courts throughout the country. They concentrate their practice in defending class-action litigation.