

FRB & FTC Issue Final Risk-Based Pricing Rule

On December 22, 2009, the Federal Reserve Board and the Federal Trade Commission (FTC) released their long-awaited joint Final Risk-Based Pricing Rule. The following is a preliminary summary of several key provisions in the final rule. NADA will disseminate a more comprehensive summary later this year.

- The Risk-Based Pricing Rule imposes a new notice requirement that takes effect January 1, 2011. It implements section 311 of the FACT Act of 2003, which significantly amends the Fair Credit Reporting Act (FCRA). It is the latest (and the last major) duty mandated by the FACT Act.
- The notice requirement is intended to improve the accuracy of credit reports by alerting consumers whose credit applications have been approved (but generally on less favorable terms) to the existence of negative information in their credit reports that they can check for accuracy and, if warranted, correct.
- This is meant to “complement” the FCRA’s adverse action notice requirement that requires creditors who deny a consumer’s credit application based in whole or part on information in a credit report to provide information about credit reports to those consumers.¹
- The Risk-Based Pricing Notice (RBPN) requirement is entirely separate from the new Model Privacy Notice that the FTC and the federal banking regulatory agencies recently issued under the FTC Privacy Rule.²
- The Risk-Based Pricing Rule generally applies to creditors that (i) engage in risk-based pricing and (ii) use a credit report to set the terms on which credit is extended to consumers.
- The rule does not apply to extensions of business credit or to lease transactions.
- Although NADA submitted detailed comments to the agencies arguing that dealers involved in three-party vehicle financing (in which the dealer enters into a credit contract with a consumer and then immediately assigns it to a finance source that already conducted underwriting on the consumer’s credit application) typically do not engage in risk-based pricing, the agencies stated that dealers acting as original creditors must comply with the new notice requirement.³
- The rule requires dealers and other creditors who use credit reports to deliver a RBPN to consumers to whom the dealer will extend credit but 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.”

¹ The Equal Credit Opportunity Act (ECOA) and its implementing regulation, Reg B, also impose an adverse action notice requirement, which is not dependent on the use of a credit report, on participating creditors who deny a customer’s credit application. For more information on the adverse action notice requirements imposed by the FCRA and the ECOA, see NADA’s *A Dealer Guide to Adverse Action Notices*.

² See www.ftc.gov/opa/2009/11/glb.shtm.

³ The agencies stated, in part: “The automobile dealer’s use of a consumer report to determine which third-party financing source is likely to purchase the retail installment sales contract and at what ‘buy rate,’ and to set the annual percentage rate based in part on the ‘buy rate,’ is conduct that fits squarely within the description of risk based pricing.... Thus, automobile dealers that are original creditors in a three-party financing transaction must provide risk-based pricing notices to consumers, in accordance with the rules.”

- Determining which credit-approved customers fit into this category has been the subject of considerable discussion and is one reason why it took the agencies six years to issue the final rule. To help creditors make this determination, the Agencies created a “Credit Score Proxy Method” and a “Tiered Pricing Method.” Although these methods are intended to simplify the comparison process, they nonetheless require creditors to separate credit customers who will receive favorable terms from those who will not and then issue RBPNs only to customers in the latter category.
- Because of the implementation challenges this creates, NADA recommended and the Agencies adopted an “Exception Notice” that creditors may issue in lieu of a RBPN. It is largely modeled on a similar type of notice that presently must be issued by auto dealers in California. The information below focuses on the requirements applicable to the Exception Notice, as it will likely be the compliance option pursued by most dealers. NADA will analyze the RBPN methods in its subsequent guidance on the topic.
- Regardless of the type of notice issued, the rule generally states that a consumer is entitled to only one notice and it is the original creditor (not the assignee creditor) who must deliver the notice. If the finance source is the original creditor, the rule permits the finance source to “arrange to have the auto dealer ... provide the notice within the time [specified if the finance source] maintains reasonable policies and procedures to verify that the auto dealer... provides such notice to the consumer within the applicable time periods.”

Exception Notice

- Unlike the RBPN, the Exception Notice may be issued (indeed must be issued) to all consumers who request credit. This avoids the need to identify a subset of customers to whom the notice must be provided.
- In order to use the Exception Notice, the notice must include the consumer’s credit score along with the following information to put the score in context:
 - 1) the range of possible credit scores under the model used to generate the score, and
 - 2) either –
 - (a) a bar graph that breaks down the range of possible credit scores into at least six bars indicating the percentage of consumers with credit scores that fall within the range of scores for each bar (as illustrated in the model notice described below), or
 - (b) a clear statement indicating how the consumer’s credit score compares to other consumers (e.g., “Your credit score ranks higher than __ % of U.S. consumers”).
- If dealers use a bar graph to comply with this disclosure requirement, they may use a bar graph prepared by the consumer reporting agency (CRA) or other person from which they obtained the credit score.
- The Exception Notice also must contain the name of the CRA or other entity that provided the score, the date on which the credit score was created, and certain statements that are intended to educate the consumer about credit reports, credit scores, and how the consumer may obtain the free annual credit report to which all consumers are entitled.
- If a dealer regularly provides the Exception Notice to consumers and (i) cannot obtain a credit score for a particular consumer because it is unavailable from the CRA or other entity from which the

dealer regularly obtains credit scores, and (ii) does not obtain a credit score for that consumer from another CRA or other entity (the rule does not require the dealer to attempt to obtain a credit score from another CRA), the dealer may provide the consumer with an Alternative Exception Notice⁴ (in lieu of a RBPN) that provides certain general information about credit reports and credit scores but does not include the consumer's credit score or the information that puts it in context.

- Dealers who obtain credit reports but not credit scores for their credit customers and are the original creditor in a credit transaction must obtain a credit score if they wish to use the Exception Notice in lieu of the RBPN.
- The Exception Notice (and, when permitted, the Alternative Exception Notice) must be (i) provided to the consumer in writing in a form the consumer may keep, (ii) clear, conspicuous, and segregated from other information provided to the consumer, and (iii) delivered as soon as reasonably practicable after the credit score has been obtained (or requested in the case of the Alternative Exception Notice), but in any event at or before consummation of the credit transaction.
- Appendix B of the rule contains optional model forms for providing the notices. Form B-4 (pages 198-199) contains the model Exception Notice and Form B-5 (page 200) contains the model Alternative Exception Notice. Appropriate use of the forms provides dealers with safe harbor protection for the disclosures used in the notice. Certain limited modifications to the form are permitted (see page 191).

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- There is no federal private right of action for violations of the Risk-Based Pricing Rule. However, the rule is subject to administrative enforcement.
- There are several other pertinent aspects of the Final Rule not included here (e.g., notice responsibilities in credit transactions involving more than one consumer, notice responsibilities for dealers who obtain more than one credit score, exceptions to the notice requirement, examples of compliance with the rule, etc.) that will be discussed in NADA's Risk-Based Pricing Rule guidance to be issued later this year.
- The final rule, including the model forms, is available at www.ftc.gov/os/2009/12/R411009riskbasedpricingfrn.pdf.

The foregoing preliminary summary of the Final Risk-Based Pricing Rule is offered for informational purposes only and is not intended as legal advice. Dealers should review the final rule in its entirety and consult an attorney who is familiar with applicable law and their operations for guidance on the full scope of their compliance obligations.

⁴ The rule does not refer to this type of notice as an Alternative Exception Notice. We have used that term to distinguish it from the Exception Notice that may be provided when the dealer is able to obtain the consumer's credit score.