VIA ELECTRONIC MAIL

August 18, 2008

Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Attention: Docket No. R-1316
regs.comments@federalreserve.gov

Federal Trade Commission
Office of the Secretary
Room H-135 (Annex M)
600 Pennsylvania Avenue, NW
Washington, DC 20580

Attention: Project No. R411009
https://secure.commentworks.com/ftc-RiskBasedPricing

**Re: FACT Act Risk-Based Pricing Rule,
Docket No. R-1316
Project No. R411009**

Ladies and Gentlemen:

In response to the notice of proposed rulemaking, HSBC Finance Corporation[1], and HSBC Bank USA, N.A., (collectively "HSBC"), are pleased to comment on the proposed rules to implement the risk-based pricing provisions of section 311 of the Fair and Accurate Credit Transactions Act of 2003 ("FACT Act"). HSBC's affiliated companies worldwide serve over 125 million customers and comprise one of the largest financial services organizations in the world. In the United States and Canada, HSBC businesses provide financial products to nearly 60 million customers. With such a broad and expansive customer base, HSBC is a significant user of credit reports.

Section 311 of the FACT Act adds a new section 615(h) to the Fair Credit Reporting Act ("FCRA"). Section 616(h) requires creditors to provide a risk-based pricing notice to consumers when the creditor uses a consumer report in connection with an application, grant, or extension of credit and, based in whole or in part on the consumer report, grants or extends credit on material terms that are materially less favorable than the most favorable terms available to a substantial proportion of consumers from or through the creditor.

The request for comment issued by the Federal Reserve System and the Federal Trade Commission (collectively, the "Agencies") outlines specific information desired by the Agencies. HSBC appreciates the opportunity to respond to the Agencies' request, and

[1] Among other companies, HSBC Finance Corporation wholly owns HSBC Consumer Lending (USA) Inc., Beneficial Company LLC, HSBC Mortgage Services Inc., HSBC Card Services Inc., HSBC Bank Nevada, N.A., and HFC Company LLC.

hopes the following information proves useful to the Agencies in their consideration of the proposed rule.

1. **<u>The Scope of the Proposed Rule Should Not Extend to Business Credit</u>** (§ .70)

HSBC supports the Agencies' approach to defining the scope of the proposed rule. Because business guarantors of business loans tend to be more sophisticated than consumers, as the Agencies noted, they have little need for the type of information about consumer credit scores and pricing that would be provided under the proposed rule. Business loan terms are often negotiated and tailored to the needs of a particular business; it is therefore not reasonable to expect commercial borrowers to compare the material terms of business loans in the same way that standardized consumer loans can be compared. Even in cases where an unsophisticated individual is starting a business and relying solely on his or her creditworthiness for a business loan, the individual is likely to have access to many types of start-up support, from accountants, lawyers, investors, financial planners, or other professionals who can assist with understanding business credit. The Agencies should not expand the scope of the proposed rule to business credit.

2. **The Scope of the Proposed Rule Should Exclude Accommodation Loans and Private Banking Loans** (§ .70)

The Agencies should apply the same analysis to private banking loans and accommodation loans made to owners and executives of commercial accounts that applies to business credit. Loans originated through the private banking division of financial institutions are not standardized and are often the result of individual negotiation. Therefore, it is difficult or impossible to compare such loan pricing with equivalent types of consumer credit, other accommodation loans, or private bank loans. In addition, creditors generally place less importance on consumer credit scores for underwriting these types of credit. As with business loans, accommodation loans and private banking loans are made to more sophisticated borrowers who would derive little benefit from the risk-based pricing notice. The Agencies should provide an exemption for these loan categories.

3. **The Definition of "Material Terms" in the Proposed Rule is Ideal** (§ .71(i))

We believe the Agencies' definition of "material terms" is appropriate. The definition offers different permutations for different situations and maintains simplicity. Considering too many factors in the definition of "material terms" would lead to cumbersome complexity and burdensome calculations, increasing the risk of error and enhancing consumer confusion, rather than serving any worthwhile consumer need. In particular, expanding the definition of "material terms" beyond the Annual Percentage Rate (APR) would lead to overly intricate computations when creditors must then determine whether such terms, as applied to a consumer, are somehow "materially less

favorable" than terms provided to other consumers. In addition, if creditors were to be required to consider multiple terms as "material," it would be almost impossible to compare multiple terms between consumers. For example, is it more or less "favorable" to have (on the one hand) a high interest rate, a high prepayment penalty, medium late charges, and no origination fees, versus (on the other hand) a lower interest rate, no prepayment penalty, a $39 late charge, and a high origination fee? Obviously, different consumers and different creditors would value the "favorability" of different terms in different ways. As a result of the inherent subjectivity of such choices, the Agencies' objective definition (based on the single most valued term) is highly preferred.

4. **<u>The Agencies Should Either Enhance the Definition of "Materially Less Favorable" (and Related Terms) or Delete It</u> (§ .71(j))**

The Agencies define "materially less favorable," as it applies to material terms, to mean that the terms granted or extended to a consumer differ from the terms granted or extended 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 to the other consumer. In many instances, creditors will find it very challenging to know when there is a "materially less favorable" credit term, and whether necessary disclosures can be delivered prior to a first transaction. Any provisions which include the definition "materially less favorable" will force a consideration of whether the terms being offered are "significantly greater" on a case-specific basis. As noted in the commentary, "factors relevant to determining the significance of a difference in the cost of credit include the type of credit product, the term of the credit extension, if any, and the extent of the difference…." As one example, the Agencies note that a 25 basis point APR difference would not be deemed materially different, while a 25 basis point difference for a mortgage loan might reasonably be considered material. These somewhat obvious statements, as well as the entire definition, are unhelpful because they do not provide any specific guidance to creditors. In light of the alternative approaches to disclosure provided by § .72(b), perhaps most creditors will employ the alternatives and no definition of this term is really necessary. The lack of clarity around these definitions, and the lack of definitions for the terms "most favorable terms" and "a substantial proportion of consumers" almost certainly will result in creditors using the alternative approaches to disclosure provided by § .72(b).

5. **<u>The Agencies Should Define the Term "Application" and Align it with Regulation B's Definition of the Term</u> (§ .71)**

As the Agencies have made the effort to align several key terms with definitions contained in existing related regulations, HSBC believes the Agencies should take the same approach for the term "application." Because the concept of "applying for" credit is prevalent throughout the proposed rule, and there may be some confusion as to what exactly constitutes an "application" for credit, HSBC believes the Agencies should specifically define the term "application," consistent with the term's definition in

§202.2(f) of Regulation B, and provide that it should be interpreted consistently with interpretations of the term in Regulation B.

6. **The Agencies Should Reconsider and Adjust the Cutoff Criteria for the Alternative Compliance Options (§ .72)**

The Agencies have proposed several methods which a creditor can use to determine whether a consumer is entitled to a risk-based pricing notice. HSBC supports the Agencies' efforts to offer creditors flexibility when making this determination. The proposed cutoff criteria, however, may result in over-notification, which will make the notice less instructive to consumers and more burdensome for creditors. We ask the Agencies to reconsider the cutoff criteria for the credit score proxy and tiered pricing proxy methods to avoid this result.

HSBC recommends that the Agencies establish the credit score proxy breakpoint at the point where the risk-based pricing notice would be sent to approximately 40% of consumers for a particular class of product. We also ask the Agencies to clarify that creditors may determine the cutoff score based on specific product lines, even if those product lines relate to the same type of loan. For example, a mortgage lender may offer many distinct types of mortgage loans with different pricing models based on a number of factors, such as acquisition channel, type of collateral, and lien position. Permitting creditors to recognize these distinctions between product lines will make the notice more meaningful to consumers within each product line. HSBC also recommends that the Agencies establish the tiered pricing proxy breakpoint so that consumers would receive the risk-based pricing notice if they do not fall within the top 60% to 70% of pricing tiers. Both of these recommendations would avoid the likelihood of over-notification under the current proposal.

7. **The Agencies Should Clarify that Credit Card Issuers Have the Same Alternative Compliance Options that Other Types of Creditors Have (§ .72)**

HSBC supports the Agencies' efforts to offer creditors flexibility in choosing among several methods which a creditor can use to determine whether a consumer is entitled to a risk-based pricing notice. At the same time, we urge the Agencies to clarify that credit card issuers are not required to use only the credit card proxy method. While the general language of § .72 implies that creditors can select the compliance alternative that best suits a particular product, the statement that a credit card issuer "must" provide a risk-based pricing notice if the conditions of the credit card proxy are met may indicate that only this particular method of compliance is mandatory for those issuers. We urge the Agencies to give credit card issuers the same flexibility that is granted to other creditors, and clearly state that credit card issuers are not required to use only the credit card proxy method.

8. The Agencies Should Change the Timing for Risk-Based Pricing Notices Applicable to Retail Point of Sale Transactions (§§ .72 and .73(e)(1)(ii))

We support the Agencies' balanced and reasonable determination that intermediaries who are not original creditors are not the appropriate parties to provide risk-based pricing notices to consumers. We agree with the Agencies' concern that requiring intermediaries such as dealers and brokers to provide the notice would cause consumers to receive multiple notices from the intermediary as well as the original creditor, which would just confuse and annoy consumers, defeating the purpose of the notice.

Another category of intermediary raises similar concerns: retail merchants that accept applications for private label and co-branded credit products. These extensions of credit take place in a matter of minutes while a consumer is waiting to purchase an item on credit from the retail merchant. The creditor, not the merchant, reviews and approves the credit application, and grants the first credit extension at the point of sale. In this case, the merchant does not know whether the terms granted to a particular applicant are materially less favorable than those granted to other applicants. It is impossible for the merchant to determine whether a risk-based pricing notice would be required in any particular case, without receiving comparison information, which the creditor has no practical means to provide to the merchant at the time the sale is being consummated. The proposed rule does not permit the option of providing pre-printed risk-based pricing disclosures with the application. In addition, the timing requirements of § .73(e)(1)(ii) requires notices to be provided as soon as reasonably practicable after the credit score has been obtained, but in any event at 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).

These notice requirements, if adopted, would create significant issues for retail credit programs. Because the consumer wishes to complete the transaction immediately and leave the retail store with the item purchased, the proposed rule obviously contemplates having the retail merchant provide the notice. No processes or computer systems currently exist to provide the necessary information to a retail merchant for providing this new notice to consumers. Developing these processes and systems would be costly and would require significant training for retail employees, who are not credit experts. In addition, it is inappropriate to provide this private and sensitive credit rating (and/or credit scoring) information to third-party retail merchants in any event. Further, real time disclosure of credit bureau information prior to the retail purchase appears to serve no purpose in the retail transaction, because the consumer obviously cannot obtain, review, and correct any potential inaccuracies in the consumer report prior to purchasing the item at the retail store. Coming at the retail store, the risk-based information would cause significant confusion to consumers. Some consumers could insist on resolution of potential credit report disputes, which the retail employees would have no ability to accomplish.

There is no substantive difference between real-time delivery of the risk-based pricing notice as opposed to some duration closely following the transaction, such as with the delivery of the credit card itself, or with other correspondence welcoming the consumer.

HSBC therefore urges the Agencies to consider additional flexibility for providing risk-based pricing notices for point of sale transactions. We believe that the Agencies' intent can be achieved by permitting the creditor to provide the uniform language from the risk-based pricing notice in the application, and follow up with a written notice to those customers entitled to the name and contact information of the consumer reporting agency. In the alternative, the notice given at application could include a telephone number and website address for the customer to contact to learn whether the customer is entitled to the additional information.

9. The Exception for Specific Material Terms Should Include a Range of Rates Provided in a Firm Offer of Credit (§ .74(a))

HSBC commends the Agencies for recognizing and providing certain exceptions to the general requirements regarding risk-based notices. We ask the Agencies to consider expanding the scope of certain exceptions. First, the proposed regulation provides that a risk-based pricing notice is not required if the consumer applies for specific material terms and is granted those terms. The proposal clarifies that the term "specific material terms" means a single material term or set of material terms, such as a single annual percentage rate, and not a range of rates. The example provided explains that if a consumer receives a firm offer of credit from a credit card issuer with a single rate, based in whole or in part on a consumer report, a risk-based pricing notice is not required to be provided if the consumer applies for and receives a credit card with that advertised rate. In this example, the creditor sets the material terms of the offer before, not after, the consumer applied for or requested the credit. The exception will not apply if the terms (APR) are specified by the creditor using the consumer report after the consumer applies for or requests credit and after the creditor obtains the consumer report.

We urge the Agencies to expand this exception to include a range of rates provided to the consumer in a firm offer of credit. When a consumer is provided a range of rates in connection with a firm offer of credit, those rates should also be considered a set of material terms for which the consumer is applying, and therefore, subject to the exception. The FCRA requires significant and extensive disclosures in connection with firm offers of credit. These comprehensive disclosures make clear to the consumer that the consumer's credit file was reviewed in order to make the consumer an offer and that further review will be required in order to establish the consumer's eventual rate. Although the final rate provided to a consumer is established after the consumer applies for credit, the rate is established based on a set of material terms adopted by the creditor prior to conducting the prescreening process.

The Agencies correctly noted that requiring a notice in connection with prescreened solicitations will not significantly benefit consumers, but would impose substantial burdens on creditors and the credit reporting system. Similarly, requiring a notice once a final rate is established based on preset criteria also will not significantly benefit consumers, and would impose substantial burdens on creditors and the credit reporting system.

10. The Agencies Should Clarify the Prescreening Exception to Include Use of a Credit Report After the Consumer Responds to the Offer (§ .74(c))

Under the proposed rule, a risk-based pricing notice would not be required if the creditor obtains a consumer report that is a prescreened list as described in Section 604(c)(2) of the FCRA and uses the consumer report for the purpose of making a firm offer of credit to the consumer as described in Section 603(1) of the FCRA. This exception applies only when a consumer report is used to set the terms offered in a prescreen solicitation to a consumer at the pre-application stage. This exception would not apply in connection with the creditor's use of the consumer report after the consumer responds to the prescreened offer. As discussed above, we urge the Agencies to consider including as an exception a creditor's use of the consumer report after the consumer responds to the prescreened offer. As noted in the example included in the proposal, a creditor typically obtains and uses a consumer report after the consumer responds to the prescreened offer for purposes of establishing the interest rate applicable to an account. This subsequent use by a creditor of the consumer report is an extension of the original prescreening and should not be treated differently. As noted above, the FCRA requires that significant and extensive disclosures be given in connection with firm offers of credit. These comprehensive disclosures make clear to the consumer that the consumer's credit file was reviewed in order to make the consumer an offer and that further review will be required in order to establish the consumer's applicable rate. Although the applicable rate provided to a consumer is established after the consumer applies for or requests the credit advertised in a firm offer of credit, the rate is established based on a set of material terms adopted by the creditor prior to conducting the prescreen. As a result, using the consumer report after the consumer responds to the firm offer of credit is not significantly different from using the consumer report in a prescreened list and should not be the basis for an additional disclosure.

11. The Agencies Should Clarify the Required Source of Credit Score Distribution Data (§ .74(d)(1)(ii)(E))

This Section permits creditors to provide a "graph or statement obtained from the person providing the credit score" in order to satisfy the requirement to disclose the distribution of credit scores among all consumers using the same scale as that of the credit score provided to the consumer. Many creditors use "merged" or combined credit bureau reports from more than one consumer reporting agency, however, in reviewing credit applications. This enhanced underwriting process should only be encouraged, because it produces more accurate, timely, and effective data about consumers.

In this case, it would be impossible for the creditor or the entity providing the merged report to provide a single distribution of scores to represent the information obtained from the merged credit report information. Frequently the detailed contents of the separate reports are combined into one merged report, but the credit scores are not

merged. As a result, the entity providing the merged report cannot provide a single credit score distribution, and providing multiple credit score distributions is obviously unhelpful to consumers. To accommodate this situation, the Agencies should permit creditors to provide distribution data from any one of the national consumer reporting agencies that contributed to the merged report or whose credit score was used in underwriting (even if other credit scores are also used in underwriting). We propose that the Agencies clarify this requirement to permit use of a graph or statement obtained from "one of the persons" providing a credit score.

12. **The Agencies Should Provide for Annual Updates to the Distribution of Credit Score Information** (§ .74(d)(1)(ii)(E))

We also ask the Agencies to define how frequently creditors must update the bar graph or statement of comparison. Because credit score distributions change gradually over time, we believe that recalibration of the calculations on an annual basis would give consumers a reasonable means of comparing their credit scores with the broader population and would not place undue compliance costs and burdens on creditors.

13. **HSBC Supports the Proposed Rule of Construction** (§ .75)

It is appropriate for the consumer to receive no more than one risk-based pricing notice for a single extension of credit, as the Agencies have proposed in § .75.

14. **The Agencies Should Clarify that Only One Notice is Required for Joint Applicants.**

We request the Agencies to clarify who should receive the risk-based pricing notice when there are two or more applicants. If the creditor approves the application based on the credit score of one applicant, and the creditor is using the credit score disclosure option, the risk-based pricing notice should be sent solely to that applicant, in order to avoid distributing this private (and potentially sensitive) information to third party co-applicants. On the other hand, even if the creditor is using the standard risk-based pricing notice, compliance with the notice requirements should be satisfied where the creditor gives notice to the primary applicant. This is consistent with most consumer notices, where

15. **The Agencies Should Clarify that the Notice is Not Required for Credit Approvals that Do Not Result in an Extension of Credit.**

In addition to the rule of construction provided in § .75, it would be appropriate for the Agencies to clarify that a risk-based pricing notice is not required in situations where credit is approved and offered to a consumer, but the consumer decides not to proceed to

consummate the extension of credit. Many times a consumer will be approved for credit, potentially on material terms that are less favorable than the most favorable terms available to a substantial proportion of consumers, and will decide not to proceed with an extension of credit (perhaps by not clicking through on an Internet site, or by indicating non-interest to a telephone representative of the creditor and hanging up). In these cases, no risk-based pricing notice should be required. This is consistent with the language of proposed § .72, in which notices are required where the creditor "grants, extends, or otherwise provides credit." The Agencies used the word "otherwise," indicating that the proposed rule only applies to circumstances that result in the provision of credit. Because the words "grant" and "extend" might be more broadly construed, however, it would be appropriate for the Agencies to provide a rule of construction that more clearly excludes the situation where the consumer decides not to proceed.

HSBC appreciates this opportunity to comment on the proposed regulation.

If there are any questions concerning this letter, or if the Agencies require additional information, do not hesitate to contact Jeff Wood at 224-544-2948 or Patricia Grace at 716-841-5733.

Sincerely yours,

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