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By electronic delivery

18 August 2008

Jennifer J. Johnson
Secretary
Board of Governors
of the Federal Reserve System
20th St. and Constitution Avenue, NW.
Washington, DC 20551
regs.comments@federalreserve.gov

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

Re: FACT Act Risk-Based Pricing Rule
FRB Docket Number R-1316
FTC Project No. R411009
73 *Federal Register* 28966, 19 May 2008;

Dear Sir or Madam,

The American Bankers Association (ABA) provides these comments on the rule proposed by the Federal Reserve Board and the Federal Trade Commission (collectively, the Agencies) related to the their proposed regulation to implement the risk-based pricing provisions in section 311 of the Fair and Accurate Credit Transactions Act of 2003 (FACT Act), which amends the Fair Credit Reporting Act (FCRA). The proposed rules 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 that are materially less favorable than the most favorable terms available to a substantial proportion of consumers from or through that creditor. The proposal also provides for two alternative means by which creditors may determine when they are offering credit on material terms that are materially less favorable. The proposal also includes certain exceptions, including an exception for creditors that provide the consumer's credit score along with additional related information.

ABA brings together banks of all sizes and charters into one association that works to enhance the competitiveness of the nation's banking industry and strengthen America's economy and communities. Its members – the majority of which are banks with less than $125 million in assets – represent over 95 percent of the industry's $13.3 trillion in assets and employ over 2 million men and women.

ABA appreciates the Agency's flexibility in interpreting vague and sometimes contradictory statutory language in order to produce a practical and flexible rule that will help improve customer understanding of the credit decision process. We also commend the Agencies for their outreach to a variety of different creditors and industry representatives in order to understand better risk-based pricing as it is used in the various credit markets. Overall, the proposal reflects the efforts of the Agencies to understand the challenges and complexities of providing a risk-based pricing notice and the difficulty and inappropriateness of applying a single rule to a variety of very different loan products. We offer a number of suggestions to help minimize costs and compliance burdens and to clarify the requirements.

Definitions.

Under the proposal, users of consumer reports are required to provide a "risk-based pricing notice" if they:

- Use 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 personal, family, or household purposes; and

- Based in whole or in part on the consumer report grants, extends, or otherwise provides 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.

Under Section 222.71 of the proposal, "material terms," in effect, means the annual percentage rate (APR). "Materially less favorable" means:

> [W]hen applied to material terms, 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 granted or extended to the other consumer. For purposes of this definition, factors relevant to determining the significance of a difference in cost include the type of credit product, the term of the credit extension, if any, and the extent of the difference between the material terms granted or extended to the two consumers.

We agree with the Agencies to narrow the definition of "material terms" to include only the APR, as that term is the one most affected by information contained in the consumer report and is recognized as best representative of the cost of credit. In addition, as the Agencies acknowledge, "the pricing of credit products is complex", and focusing on a single term as proposed provides a more feasible means of identifying which customers should receive the notice.

In addition, we support the proposed explanation of "materially less favorable." While it poses some uncertainty, the flexibility it provides is appropriate and necessary given that a single rule or test will not be suitable for every product type or every creditor. In addition, though we do not expect most banks to use it, some, such as those who do not use credit scores or who have small loan volume, may find it to be an appropriate alternative.

General disclosure requirements for risk-based pricing notices.

The proposal offers a number of options to comply with the proposal. Lenders may provide a risk-based pricing notice using one of the following:

1. Comparison of material terms offered to each consumer and the material terms offered to other consumers in "similar types of transactions";

2. Credit score proxy method for a "given class of products;"

3. Tiered pricing for a "given class of products;" or

4. Credit card proxy.

In lieu of a risk-based pricing notice, the lender may provide a credit score disclosure pursuant to the exceptions.

We appreciate the Agencies' efforts to accommodate different situations by offering several options. The proposal in general offers a practical solution to difficult statutory language.

We request that the Agencies use consistent terminology when referring to credit products. We also request that the Agencies make clear that whatever option is selected, creditors may distinguish in their analysis among different types of products, based on loan purpose and term characteristics as well as delivery channel. The proposed comparison option refers to "similar types of transactions," but the options that follow refer to a "class of products." The proposal is not clear with regard to the intended distinction between these terms or the meaning of "similar types of transactions" in the context of what is more commonly referred to as a "product." Accordingly, to eliminate ambiguity, the final rule should consistently refer to "type of product."

Lenders should be permitted to distinguish among "types of products" in making the determination so as to make the analysis more precise and relevant for customers. For example, there are different types of auto loans (e.g., for used cars and new cars) and mortgage loans (e.g., nonconforming and FHA), and different pricing models may be used for each. Accordingly, the impact on the customer of the particular risk-based pricing model will vary depending on which type of loan is involved. Similarly, pricing may legitimately vary based on delivery channel. For example, accounts opened via the Internet may present more risk than those opened face-to-face and therefore may be priced differently.

We suggest that the Agencies use the term "type of product" and explain that this envisions the distinctions described above. The term "class of products" suggests a broader group, though the term may be acceptable if the rule is clear that the appropriate classifications may be made as described above.

We also suggest that under 222.72(b) the final rule qualify references to "consumer" by adding "receiving similar types of products," so that the sentence reads—

> A person may make a determination under paragraph (a) of this section by directly comparing the material terms offered to each consumer receiving a similar type of product and the material terms offered to other consumers receiving similar types of product.

Otherwise, it is not clear which "consumers" are involved.

Credit score proxy method. Under the credit score proxy option, creditors would determine the score that represents the point at which approximately 60 percent of its "consumers" have lower credit scores and provide notice to those below the 60 percent threshold. While this approach is appreciated, we do not expect it to be particularly practical as the alternatives are less burdensome. In addition, the reasoning for the 60 percent threshold is not clear, which we believe would result in a confused message to consumers.

In many cases, under this proposed threshold, the notice will send the wrong message to some customers and cause them alarm. The negative notice suggests and will likely be interpreted to mean that the recipient has credit problems: "The terms offered to you may be less favorable than the terms offered to consumers who have better credit histories." However, depending on the creditor's particular experience and the narrowness of the range of credit scores involved, the consumer might in fact be a very good or even "average" risk and may not in fact be receiving an offer that is "materially less favorable." While we recognize that it is not possible to arrive at a perfect solution, we suggest that the proposed threshold will cause unnecessary consumer angst and should be lowered to a more meaningful number such as 40 percent.

Tiered pricing method. For similar reasons, we suggest that the Agencies adjust the proposed thresholds presented in the tiered pricing method. Under this method, lenders that set terms within "one of a discrete number of pricing tiers" may comply by providing a notice to each customer who does not qualify for the top tier. For example, a lender using five or more pricing tiers must send the notice to those who do not qualify for the top two tiers. The result will be customers with good credit histories who are not necessarily receiving a "materially less favorable" rate will receive a notice informing them that there are other customers "who have better credit histories." We suggest that the threshold be changed so that the notice would be sent to consumers falling within the bottom 30-40% of tiers.

Median APR method. The Agencies have asked whether there are other methods for determining who should receive a risk-based pricing notice. We suggest that the final regulation permit a "median APR method." Under this method, creditors would determine the median APR of consumers who received a particular type of product over a period of time and, going forward, provide the notice to those receiving an APR less favorable than the median APR. For example, assume that out of ten borrowers three received an 8 percent APR, four received a 7 percent APR, and three received a 6 percent APR. The median is 7 percent and thus, going forward, consumers who receive an 8 percent or higher APR would receive the notice. While not perfect, it comes closer to the goal of determining who received "terms materially less favorable than the most favorable material terms available to a substantial proportion of consumers" than either the credit score proxy method or the tiered pricing method. Under both those methods, as discussed, people receiving favorable rates might receive the notice, while under the median APR method it is less likely. This method is also less vulnerable to manipulation because, being based on the median, providing low rates to a small portion of people will not distort the results. Under this method, people who do not receive the notice are all being priced as well as or better than the median borrower. In addition, this option might be useful to lenders for whom the proposed methods are inappropriate or too complicated and for whom the credit score exception is not practical because, while they use credit reports, they do not purchase credit scores. As with the credit score proxy method, the lender would have to determine periodically the median APRs.

Account review. Under the proposal a notice must be provided if a consumer report is used "in connection with a review of credit that has been extended to the consumer" and an APR increased based in whole or in part on that report. We strongly recommend that this requirement be deleted.

We do not believe that Congress intended to extend this provision to account review. Elsewhere in FCRA, for example, the term "review" is inserted specifically: Section 604(a)(3)(A) refers to the use of information with regard to the "extension of credit to or review of collection of an account." Similarly, Section 604(a)(3)(F) allows use of a report "to review an account. . ." In contrast, Section 615(h) refers to "an application for, or a grant, extension, or other provision of, credit" and does not mention "review." In addition, the risk-based pricing notice was intended to address concerns that adverse action notices are not required when a counteroffer is made and accepted. The risk-based pricing notice was intended to fill this "gap." Extending it beyond this context was not the Congressional intent.

Content and timing of risk-based notice.

Content. The notice must include certain information, including a statement that the terms offered "may be less favorable than the terms offered to consumers with better credit histories." The Agencies request comment on whether they should use a different phrase, "such as the terms are 'are likely to be' less favorable." We recommend against adoption of this phrase or any further suggestion that the customer is in the lowest level of creditworthiness, since, as noted earlier, that will often not be the case. The Agencies themselves note that "some consumers may receive a risk-based pricing notice even if they receive the most favorable terms available from that creditor." Overstating the matter only serves to confuse and unnecessarily upset customers.

Timing of notice. Under the proposal, lenders must generally provide the notice before consummation of the transaction, or before the first transaction in the case of open-end credit, but not before the decision to approve an application is communicated to the consumer. We strongly recommend that the Agencies make an exception for accounts opened at point of sale. In these cases, it is not in the interest of the customer's privacy nor is it practical to provide the notice at the point of sale as proposed.

First, the customer's actual credit score or a notice that "other people have better credit histories than you do" would necessarily have to be shared with the customer service representative opening the account, for example, the sales clerk at a department store. Many customers would not appreciate or want that information to be shared in this fashion. In addition, financial privacy sensitivities tend to be lower in these settings.

Second, it may not be practical to provide the notice in this setting. The credit score disclosure, for example, must be tailored so it cannot be printed in advance. However, machines to receive the information (including the credit score and consumer reporting agency information) and printers are usually not an option in these settings.

Instead, we suggest that in these instances the notice be provided subsequent to the pricing decision, as the Agencies have proposed for the account review notice. In this case, the notice could be provided with the credit card. The impact on consumers is limited because they still receive the account terms prior to making a decision to open an account so are in a position to make an informed decision.

Exceptions.

Credit score disclosure. The Agencies list a number of exceptions to the requirement to provide a risk-based pricing notice. Among them is a credit score disclosure similar to the credit score disclosure currently required for certain loans secured by residential real property under Section 609(g) of FCRA. The proposed notice must include the credit score along with information explaining how the customer's score compares with other consumers. We strongly support this exception and appreciate the Agencies' efforts to provide a workable option.

We recommend clarification that lenders using proprietary scores have the option to provide a credit score obtained from an entity regularly engaged in the business of selling credit scores. The Supplementary Information states—

> If. . . a person uses a credit score that was not created by a consumer reporting agency, such as a proprietary score, that person is permitted to satisfy the exception either by providing the proprietary score to the consumer or by providing to the consumer a credit score and associated information it obtains from an entity regularly engaged in the business of selling credit scores. In addition, a person that does not use a credit score in its credit evaluation process is permitted to rely on this exception by purchasing and providing . . . a credit score and associated information it obtains from an entity regularly engaged in the business of selling credit scores.

We agree with this approach, which is consistent with the current credit score disclosure requirements for certain mortgages. Customers receive useful information about their creditworthiness, but compliance is more flexible. To add certainty about the availability of these options, we recommend that they be specifically noted in the regulation. However, we also note that it may not be a practical option for lenders who use credit reports but do not purchase credit scores, as their choice will be to purchase specially the scores or provide an adverse action notice. We understand that scores are generally not available for purchase just to satisfy risk-based pricing disclosures, but would need to be purchased at the outset as a regular part of the bank's acquisition of the credit reports they obtain. This creates an undue expense for the banks that underwrite without using credit scores.

In addition, the proposal provides that the credit score proxy be based on the scores of the creditors' "consumers." It is not clear whether this represents all applicants or applicants who are offered credit. Because the general requirement relates to "the most favorable material terms *available* to a substantial proportion of consumers," (emphasis added), the Agencies should clarify that the determination should be based on applicants who are actually granted credit.

Notification of applicants.

The proposal does not appear to address instances when multiple applicants are involved. Under Section 202.9(f), adverse action notices need only be given to one of the applicants, but must be given to the primary applicant where one is readily apparent. We suggest that the Agencies adopt a similar approach so that the lender need only provide one risk-based pricing notice or credit score disclosure to one of the applicants, to the primary one if readily apparent. The reasons for only requiring a single adverse action notice apply with similar force to the risk-based pricing notice, which was intended to address any "gap" for adverse action notices in the event of a counteroffer.

Responsibility of "original creditor" and multi-party transactions.

We agree with the Agencies' conclusion that the person to whom the obligation is initially payable, i.e., the original creditor, is responsible for providing the risk-based pricing notice or other notices based on an exception, e.g., the credit score disclosure. For example, if the auto dealer is the person to whom the loan obligation is initially payable, the auto-dealer must provide the notice, even if the auto dealer immediately assigns the loan to another creditor. This is a sensible and practical approach for a number of reasons. The auto dealer usually pulls a credit report or score as part of its business process, even before it knows which creditor will be assigned the loan. In addition, the assignee will not be in a position to provide the notice in a timely fashion, that is, before consummation and therefore must rely on the auto dealer. It is thus more appropriate for the auto dealer, in such an example, to have the legal responsibility as it is in the best position to ensure proper delivery.

Implementation period.

ABA believes that for some of its members, especially those planning to provide the credit score disclosure, one year may be sufficient time to implement the final rule. However, for others, such as credit card issuers choosing other options that demand greater analysis and systems changes, a longer period may be needed. Compounding implementation pressures for these issuers will be final Regulation Z (Truth in Lending Act) and Regulation AA (Unfair or Deceptive Acts or Practices rule), expected at the end of the year. Implementation of these final rules will certainly require significant resources in order to interpret the rules, redesign products, resolve operational challenges, and implement those operational changes. In determining a mandatory effective date of the risk-based pricing rule, the Agencies should take into account the timing of those regulations as well and ensure sufficient time for compliance, for example, two years.

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ABA applauds the Agencies' efforts to produce a workable and flexible regulation in the fact of difficult statutory language. We believe that in general the proposal will accomplish the goal of informing consumers about the credit decision process, but with the recommendations that we recommend can offer creditors sufficient flexibility and options to minimize the compliance burden and complexity.

Sincerely,

Nessa Eileen Feddis