Office of Thrift Supervision
Department of the Treasury

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Montrice G. Yakimov
Managing Director for Compliance and Consumer Protection

September 8, 2008

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

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

SUBJECT: Comments on FACT Act Risk-Based Pricing Rule
Docket Nos. FRS-2008-0173 and FTC-2008-0042

Dear Ms. Johnson and FTC Secretary:

The Office of Thrift Supervision has reviewed the rule proposed by the Federal Reserve Board and the Federal Trade Commission to implement the provisions of Section 311 of the Fair and Accurate Credit Transactions Act of 2003. We are encouraged by the features of the May 19, 2008 proposed rule that would generally require creditors that use consumer reports to provide a risk-based pricing notice to consumers when they offer credit terms that are materially less favorable than those they offer to a substantial proportion of consumers. To assist in this effort, we submit the attached suggestions.

If you have any questions regarding our comments, please contact either April Breslaw, Director, Consumer Regulations at (202) 906-6989, Suzanne McQueen, Consumer Regulations Analyst at (202) 906-6459, or Richard Bennett, Senior Compliance Counsel at (202) 906-7409.

Sincerely,

Montrice G. Yakimov

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Attachment

Office of Thrift Supervision
Staff Commentary on Proposed FACT Act Risk-Based Pricing Rule
Docket No. R-1316 (FRS-2008-0173) and Project No. R411009 (FTC-2008-0042)

The Federal Reserve Board (FRB) and the Federal Trade Commission (FTC) (collectively, the Agencies) have solicited comment on the proposed rules on risk-based pricing published May 19, 2008 (Draft Rules). In response, OTS offers the following comments.[1]

I. Dual regulation of covered parties by different agencies

As proposed, the Draft Rules would subject covered parties to two identical rules issued by different agencies. Compare proposed section 222.70(a) and (b) with proposed section 640.1(a) and (b). While the proposed rules indicate that compliance with either rule satisfies the "statutory requirements," see 222.70(b) and 640.1(b), that could still subject institutions to differing interpretations of the regulatory requirements imposed by the FRB and FTC. OTS strongly recommends that the Agencies revise the Draft Rules so that the scope of FRB and FTC coverage is clearly delineated and that only one agency's rule applies to any given entity. We do not read the language of FCRA section 615(h)(6)(A) referring to the FRB and FTC jointly prescribing rules to require otherwise.[2] Additionally, the FRB and FTC should publicly commit to jointly issuing any interpretations of the regulation.[3]

II. "Material terms" should include more than the Annual Percentage Rate (APR)

Congress used the phrase "material terms" (plural) to describe the type of terms that must be considered when determining whether a risk based pricing notice is necessary.[4] The Draft Rules define this phrase to include only the APR, but the Agencies seek comment on whether this definition should be expanded.[5] As there is ample support for broadening this definition, OTS encourages the Agencies to do so.

Regulation Z defines "material disclosures" broadly to refer not just to the APR, but also to terms such as the finance charge, the amount financed, the total payments, and the payment schedule. [6] These terms should be used as a model for defining the "material terms" that may trigger a risk based pricing notice if they have been varied based on information in a consumer

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[1] For the sake of simplicity, this comment primarily includes citations to the regulations proposed by the FRB. However our observations are also intended to apply to the identical set of rules proposed by the FTC.

[2] This language is less stringent than the statutory language that required the FRB and SEC to "jointly adopt a single set of rules or regulations" creating exceptions for banks from the definition of the term "broker" under section 3(a)(4) of the Securities Exchange Act of 1934. See section 101(a) of the Financial Services Regulatory Relief Act of 2006, Public Law No. 109–351, 120 Stat. 1966 (2006).

[3] The FRB and SEC made such a commitment when issuing rules to implement section 101(a) of the Financial Services Regulatory Relief Act of 2006. See 72 Fed. Reg. at 56517 ("In light of the joint nature of the final rules and the Agencies' joint rule-writing authority for the bank broker exceptions in Section 3(a)(4)(B) [footnote omitted], the Agencies will jointly issue any interpretations and responses to requests for no-action letters or other interpretive guidance concerning the scope or terms of the exceptions and rules").

[4] 15 U.S.C. § 1681m.

[5] 73 Fed. Reg. 28871.

[6] 12 C.F.R. pt. 226, nn. 36 and 48 (addressing this definition for both open and closed end credit)

report. If, in a specific transaction, the only term varied based on information in the consumer report is the APR, the APR would be the only material term for that transaction.

The Draft Rules indicate that limiting "material terms" to the APR is appropriate because, "it would not be operationally feasible for creditors to compare credit terms on the basis of multiple variables."[7] However, numerous creditors use risk-based pricing to offer a set of terms that reflect a prospective borrower's risk. Creditors across the financial services industry are apparently equipped to compare multiple terms because they adjust a combination of terms offered to borrowers based on different risks that borrowers present.

Moreover, broadening the definition of "material terms" will avoid two anomalous results. The first concerns annual membership fees for open-end credit. For charge cards, the Draft Rules would treat such fees as "material" because these cards do not have an APR.[8] On the other hand, annual membership fees would not be treated as "material" for credit cards because these cards do have an APR.[9] Employing different treatment for charge and credit cards is at odds with the approach taken under Regulation Z, which requires the same disclosure of fees for the issuance or availability of credit for both types of cards.[10] In response to the Agencies' request for comment,[11] OTS suggests that the definition of "material terms" be broadened.

The treatment of a credit card with multiple APRs under the Draft Rules is also inconsistent with the approach taken under Regulation Z. Specifically, the Draft Rules treat only the APR applicable to purchases as "material," while the APRs for cash advances and balance transfers do not receive this treatment. This approach is at odds with the one taken under Regulation Z, which requires the same disclosure for all of the aforementioned APRs.[12]

III. Determining whether notices are required

As proposed, a person must send a risk-based pricing notice if the person used a consumer report in connection with a credit decision and the terms of credit offered to a consumer were materially less favorable than the best terms offered to a substantial proportion of consumers.[13] The Draft Rule sets out requirements for determining when a notice is required. One is the direct comparison method in proposed section 222.72(b). The preamble explains that this determination should be made in a reasonable manner and provides five criteria for doing so: (1) identify the appropriate subset of customers; (2) compare the consumer to an adequate sample covering similar transactions; (3) disregard underwriting criteria that do not depend on consumer report information; (4) account for changes in the creditor's creditor base; and (5) make adjustments for terms no longer offered.[14] This guidance should be incorporated into the requirements of the rule to provide clarity to the industry.

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[7] 73 Fed. Reg. at 28971
[8] Id.
[9] Id.
[10] 12 C.F.R. § 226.5a(b)(2).
[11] 73 Fed. Reg. at 28971.
[12] 12 C.F.R. § 226.5a(b)(1).
[13] 73 Fed. Reg. at 28968.
[14] 73 Fed. Reg. at 28973-74.

As noted in the preamble, the credit score proxy method and tiered pricing method, "provide alternatives to the direct consumer-to-consumer comparison described in section 615(h) of the FCRA."[15] Consequently, these alternatives should be viewed merely as ways of defining when material terms are materially less favorable. We therefore suggest that section 222.72(b) be titled, "Determining when material terms are materially less favorable."

IV. Application to mortgage brokers in table-funded transactions

In a table funded transaction, the mortgage broker closes the loan in its own name but the obligation is initially assigned at or after settlement to a different entity. We read the preamble to the proposal to indicate that in such circumstances the mortgage broker is responsible for providing the risk-based pricing notice. [16] However, the discussion would benefit from specifically clarifying that this is what the Agencies intend.

V. Revising notices to add clarity

In response to the Agencies' request for comment,[17] OTS suggests revising the notice requirement in proposed section 222.73(a)(1)(iii) to state that the terms offered to the consumer "are" (or "will be") less favorable than the terms offered to other consumers, rather than stating that such terms "may be less favorable."[18] A risk based pricing notice will be sent because the terms are actually less favorable, as section 615(h)(1) of FCRA requires. Using "are" or "will be" will provide more clear information to consumers so that they can make better informed decisions to obtain and review consumer reports. Also in the interest of clarity, the notice requirement in proposed section 222.74(f)(1)(iii)(C) should be revised to state that credit scores are important because consumers with higher credit scores generally "are eligible for" (rather than "obtain") more favorable credit terms.[19]

VI. Potential inadvertent exception for credit card offers

Under proposed section 222.72(c)(2), credit card issuers are exempt from the requirement to compare different offers under certain circumstances. As noted above, OTS recommends that the "material terms" that must be considered when determining whether a risk based pricing notice is necessary include more than the APR. If the definition of "material terms" is expanded, this exception may no longer be valid because it may be unlikely that an issuer would offer a credit card in which only one set of material terms is available. At the very least, § 222.72(c)(2)(i) should be revised to make clear that it only applies if a credit card issuer rejects applicants who do not qualify for a credit card with a single set of material terms. If a creditor offers a different (and less favorable) set of terms to consumers who do not qualify for the initial terms offered, the exception should not apply and affected consumers should receive a risk based pricing notice.

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[15] 73 Fed. Reg. at 28974.
[16] 73 Fed. Reg. at 28972
[17] 73 Fed. Reg. at 28978.
[18] A corresponding change should also be made to Model Form H-1.
[19] OTS would make a corresponding change to Model Form H-5 and a similar change to Model Forms H-3 and H-4 to state that generally, the higher a consumer's score, the more likely the consumer is to be "eligible for" (rather than to be "offered") better credit terms.

VII. Exception for residential real property

OTS recommends clarifying whether the exception in section 222.74(f) for credit score disclosure where no credit score is available applies to loans secured by one to four units of residential real property. The preamble and rule text do not appear to specifically exclude mortgage credit, but the example in paragraph (f)(2) specifies non-mortgage credit. This leads to confusion over whether mortgage credit is covered by the exception.

VIII. Technical suggestions

In response to the Agencies' request for comment on the effectiveness of the "credit score proxy method,"[20] OTS recommends that proposed section 222.72(b)(1)(i)(A) explain how to calculate the cutoff score under this method for consumers who do not have a credit score. Would those consumers be excluded from consideration in calculating the cutoff score? Are they regarded as having a credit score at the lowest end of the range, as these consumers are treated under § 222.72(b)(1)(iii)? Are they given some other treatment? The resolution of this issue will also affect the bar charts on the model notices.

As proposed, section 222.72(d) would not require that credit card issuers provide risk based pricing notices if they use consumer report information to change cardholder APRs during account reviews. However, risk based pricing notices would be warranted if account reviews are performed for credit where there is no APR.

[20] 73 Fed Reg. 28975.