Comments of the

National Consumer Law Center
(On behalf of its Low-Income Clients)

Regarding

Notice of Proposed Rulemaking
Fair Credit Reporting Risk-Based Pricing Regulations

Federal Reserve System
12 CFR Part 222
Docket No. R-1316

Federal Trade Commission
16 CFR Parts 640 and 698

These comments are submitted by the National Consumer Law Center, on behalf of its low-income clients.[1] They are in response to the May 19, 2008 Notice of Proposed Rulemaking issued by the Federal Reserve Board (Board) and Federal Trade Commission (FTC) implementing the risk-based pricing notice requirements of the Fair and Accurate Credit Transactions Act of 2003 (FACTA), 15 U.S.C. § 1681m(h).

We commend the Board and FTC for issuing a rule that does not permit generic, boilerplate risk-based pricing notices, but instead requires a notice that is meaningful, personalized, and fulfills the function contemplated for it by FACTA. We also commend the Board and FTC for ensuring that consumers who receive a risk-based pricing notice also have a right to a free copy of their credit reports, which is separate and independent from other free credit report rights under the FCRA. We urge the Board and FTC to expand its definition of "material terms" that will trigger the risk-based pricing notice requirement.

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[1] **The National Consumer Law Center** is a nonprofit organization specializing in consumer credit issues on behalf of low-income people. We work with thousands of legal services, government and private attorneys around the country, representing low-income and elderly individuals, who request our assistance with the analysis of credit transactions to determine appropriate claims and defenses their clients might have. As a result of our daily contact with these practicing attorneys, we have seen numerous examples of invasions of privacy, embarrassment, loss of credit opportunity, employment and other harms that have hurt individual consumers as the result of violations of the Fair Credit Reporting Act. It is from this vantage point – many years of dealing with the abusive transactions thrust upon the less sophisticated and less powerful in our communities – that we supply these comments. *Fair Credit Reporting* (6th ed. 2006) is one of the eighteen practice treatises that NCLC publishes and annually supplements. These comments were written by Chi Chi Wu, editor of NCLC's *Fair Credit Reporting* treatise.

I. A Risk-Based Pricing Notice Must Only Follow an Offer of Less Favorable Terms.

Proposed § 227.73(c)/ § 640.4(c) requires that the risk-based pricing notice be provided at or after the time the decision to grant credit is communicated to the consumer. We strongly support this proposed timing requirement. This timing requirement will ensure that the risk-based pricing notice provides meaningful information, consistent with Congressional intent.

Through its timing requirements, the proposed rule ensures that the notice will serve its intended function of alerting consumers that information in their credit report actually negatively affected the credit for which they applied. Knowing that the negative information in their credit reports will actually cost money is the critical impetus for consumers to closely examine their credit reports and make the necessary corrections – either to send disputes to the consumer reporting agencies (CRAs) in the case of mistakes, or make changes to credit behavior in the case of accurate negative information.

The proposed notice is far superior to the alternative of a generic notice that some preferred, to be provided to all consumers at or around the time of application. Such a generic notice would be contrary to the clear language of the statute and to Congress's intent that the risk-based pricing notice only be sent to consumers who are provided less favorable credit as the result of their credit reports.[2]

A generic notice would read like boilerplate, and thus be absolutely useless in assisting consumers in learning of potential problems or errors in their credit reports. It would be seen as a formality, and as the Supreme Court has noted in the FCRA context, "formalities tend to be ignored."[3]

In contrast, a meaningful risk-based pricing notice would go far in alerting consumers of the need to obtain and review their credit reports. Like the adverse action notice, it would serve as a kind of warning system. As former FTC chairman Timothy Muris stated:

> Adverse action notices are a critical first step in the "self help" system for correcting inaccuracies in the consumer reporting system. Consumers are in the best position to know whether the information in their consumer report is accurate. The adverse action notice informs them that the reason for denial was based, at least in part, on the report. With the notice, consumers have specific incentives to correct inaccurate data.[4]

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[2] For analysis of why a generic notice is contrary to the statute and Congressional intent, see Letter from National Consumer Law Center et al. to Chairman Alan Greenspan and Chairman Deborah Platt Majoras (Feb. 2, 2005). A copy of this letter is attached to this comment as Attachment 1.

[3] Safeco Ins. Co. of America v. Burr, 127 S. Ct. 2201, 2214 (2007).

[4] Prepared Statement of the Federal Trade Commission, Chairman Timothy J. Muris, Before the House Committee on Financial Services (July 9, 2003).

Indeed, there is evidence that the adverse action notices do fulfill this function - when consumers requested a copy of their reports after receiving adverse action notices, a remarkable 75% filed a dispute asserting information was inaccurate.[5] With the proposed rule's timing requirements, the risk-based pricing notice will be able to serve a similar function.

II. The Risk Based Pricing Notice Should Trigger the Right to a Free Credit Report in Addition to other Free Credit Report Rights.

Proposed § 222.73(a)(vi)/ § 640.4(a)(vi) requires the risk-based pricing notice to state that consumers who receive the notice have the right to a free copy of their credit reports. The Supplementary Information explains that this right is in addition to their right to a free annual report under Section 1681j(A)(1) or their right to a free report under other circumstances (e.g., Section 1681j(c), Section 1681c-1(a)(2) and (b)(2)). We strongly support this interpretation. It is entirely consistent with the plain language of Section 1681m(h)(5), which states:

(B) CONTENT AND DELIVERY OF NOTICE – A notice under this subsection, shall at a minimum –
(A) include a statement informing the consumer that the terms offered to the consumer are set based on information from a consumer report;
(B) identify the consumer reporting agency furnishing the report;
(C) include a statement informing the consumer that the consumer may obtain a copy of a consumer report from that consumer reporting agency without charge; . . .

This statutory language shows that the credit report to be provided as the result of the risk-based pricing notice is a new requirement, separate and independent from the other free report rights under the FCRA. This is evident because 1) there is no cross reference to Section 1681j(A)(1) or any other FCRA section that otherwise requires a free report to be provided to consumers, and 2) the language tracks the same requirement for the adverse action notice in another subsection of the same section (Section 1681m(a)(3)(A)).

As discussed above, the risk-based pricing notice serves as a warning system that something is amiss in the consumer's credit file. Requiring CRAs to provide free reports when consumers are subjected to risk-based pricing achieves the same goal as when consumers are given free reports after receiving adverse action notices. A risk-based pricing notice without a right to a free report will frustrate this purpose. By including the "without charge" language, Congress facilitated this vital consumer first step of "self-help."

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[5] *Credit Reports: Consumers' Ability to Dispute and Change Inaccurate Information: Hearing before the House Committee on Financial Services*, 110th Congr. (2007) (statement of Leonard A. Bennett), at 4, *available at* http://www.house.gov/apps/list/hearing/financialsvcs_dem/osbennett061907.pdf.

III. The "Material Terms" of Credit Encompass More Than the Annual Percentage Rate.

Proposed § 227.71(i)/ § 640.2(i) defines the "material terms" of credit – which serve as the measure of comparison to trigger the risk-based pricing notice – as limited to the annual percentage rate (APR). While the APR is undeniably a very critical term in the cost of credit, it is not the only "material term." This is especially true in the open-end/credit card context, where the APR encompasses only the periodic interest rate, and does not include the impact of fees. Thus, we strongly oppose limiting the concept of "material terms" to the APR.

In general, we believe that any change to a credit transaction that is based upon credit history or credit score should be considered material; otherwise why would the creditor go to the trouble of changing the term? More particularly, we discuss specific recommendations for critical terms that should be considered "material" with respect to credit cards and auto loans. We do not discuss mortgage loans because most consumer mortgages will be covered by the exception for creditors who give the mortgage score disclosure.

Credit cards. As the Board and FTC well know, the APR for credit card purchases is far from the only critical pricing element of credit cards. Fees have been an increasingly prominent cost of a credit card, and the plethora of fees seems almost unlimited.[6] Fees are an especially critical part of the cost of credit for subprime cards, especially the predatory "fee-harvester" cards that we have written about.[7] For example, the First Premier card discussed in our report offered a 9.9% APR but imposed $178 in fees on a $250 credit line.[8] Under the Proposed § 227.71(i) / § 640.2(i), this credit card has better "material terms" than a prime card with a 12% purchase APR and no fees.

The need to include fees in the definition of "material terms" is even more critical for creditors that offer both prime and subprime cards. For example, Capital One offers a "Platinum" card with an APR of 8.65% for consumers with "Average credit" and a "Platinum" card with an APR of 12.9% for consumers with "Good credit."[9] Why does the card for "Good credit" carry a higher APR? Perhaps because there is no annual fee for that card, while there is a $39 annual fee for the card for those with "Average credit." Yet according to Proposed § 227.71(i)/ § 640.2(i), the "Good credit" card is the card with worse "material terms." Under the proposed rule, the consumer who applies for a Capital One Platinum card and is given the more expensive card for "Average credit" will not be entitled to a risk-based pricing notice. The Board itself has noted the example of the Capital One "Clarity" card that has a 0% periodic interest APR but imposes a fee of $6

[6] For a discussion of the myriad fees charged by credit card issuers, see National Consumer Law Center, et al., *Comments to the Federal Reserve Board's Advance Notice of Proposed Rulemaking--Review of the Open-End (Revolving) Credit Rules of Regulation Z*, Docket No. R-1217 (Mar. 28, 2005), available at www.consumerlaw.org/issues/credit_cards/content/open_end_final.pdf.
[7] Rick Jurgens and Chi Chi Wu, *Fee-Harvesters: Low-Credit, High-Cost Cards Bleed Consumers*, National Consumer Law Center, Nov. 2007.
[8] *See also* http://www.creditcards.com/first-premier.php (visited Aug. 18, 2008).
[9] http://www.creditcards.com/Capital-One.php (visited Aug. 14, 2008).

per $1000 per month. 72 Fed. Reg. 32,948, 33,020 (June 14, 2007). Consumers who receive a credit card like the Clarity card will never be entitled to a risk-based pricing notice, even if the fee were much higher and translated into triple digit effective APRs.

Auto loans. For auto loans, there are a number of other critical factors in pricing in addition to the APR. These include the amount of the down payment and whether to require a co-signer. In fact, one of the most common practices in auto loans is for the dealer to require a consumer to provide a co-signer due to the consumer's allegedly lower credit score. A consumer in this situation has been affected by negative credit history just as surely as a consumer whose APR is raised due to a low credit score.

Thus, we recommend that Proposed § 227.71(i)/ § 640.2(i) be revised to state:

> (i) *Material terms* means any monetary or contractual terms that the person varies based on information in a consumer report, including but not limited to:
>
> (1) the annual percentage rate required to be disclosed under 12 CFR 226.6(a)(2) or 12 CFR 226.17(c) and 226.18(e);
> (2) the amount of any fees charged for the issuance or availability of credit;
> (3) the amount of any down payment or deposit; or
> (4) whether the person requires a co-signor or guarantor.

IV. Other provisions

Some of the other provisions of the proposed rule that we briefly comment upon:

- We support the provision in Proposed § 222.72(d)/§ 640.3(d) requiring a risk-based pricing notice to be provided when there is an account review that results in an increase in the consumer's APR.
- We support requiring personalized notices, particularly the statement required in Proposed § 222.73(a)(iii)/§ 640.4(a)(iii) and Model Form H-1/B-1 that "The terms offered to you may be less favorable than the terms offered to consumers who have better credit histories."
- We support Proposed § 222.75(b)/§ 640.6(b), which requires that the person to whom the loan is initially payable must provide the risk-based pricing notice. This is especially critical in auto loans, where the credit transaction is usually consummated with the execution of the Retail Installment Sales Agreement, which binds the consumer and for which the dealer is the lender. However, because auto loans are often the subject of abusive yo-yo transactions, we also believe that the Board and FTC should require that a financing source who rejects an applicant by refusing to buy the loan must provide an FCRA adverse action notice as well.

V. Conclusion

The Board and FTC have issued a strong proposal in requiring that the risk-based pricing notice be sent after the creditor uses the consumer's credit history in deciding on what terms to grant credit, and by requiring a separate right to a free credit report after the notice is sent. These two proposals are the first two components of a three-part system intended ultimately to increase accuracy in credit reporting. Consumers receive a meaningful notice that alerts them about potential problems in their credit report. They then have the right to order a free copy of that report. They have the further right under the FCRA to seek correction of inaccurate information contained in the report through a formal dispute process with the CRAs. Together, these three rights provide consumers the self-help tools to enable them to secure the fairness and accuracy that Congress expressly intended the FCRA to promote in the nation's credit reporting system.

ATTACHMENT 1

NATIONAL
CONSUMER LAW
CENTER INC

1001 Connecticut Avenue, NW,
Suite 510
Washington, DC 20036
Tel. (202) 452-6252
Fax (202)463-9462
consumerlaw@nclc.org
http://www.consumerlaw.org

February 2, 2005

VIA FACSIMILE

Honorable Alan Greenspan
Chairman, Board of Governors
Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, DC 20551

Honorable Deborah Platt Majoras
Chairman, Federal Trade Commission
600 Pennsylvania Avenue, N.W.
Room H-440
Washington, DC 20580

Re: FACTA Risk-Based Pricing Notice Rulemaking

Dear Chairman Greenspan and Chairman Majoras:

As you near final considerations for the risk-based pricing regulations, the undersigned representatives of consumers urge you to require meaningful information consistent with Congressional intent. Congress clearly anticipated that this new risk-based pricing notice must be only provided in *response* to a credit decision particular to the consumer, and that this new notice would trigger a *new* right to a free credit report which does not otherwise exist under the Fair Credit Reporting Act.

Risk-Based Pricing Notice Must Only Follow an Offer of Less Favorable Terms

For the new risk-based pricing notice to correspond with Congressional intent, the notice must alert consumers that information in their credit report *actually negatively affected* the credit for which they applied. Knowing that the negative information in the credit report will actually cost money is the critical impetus for the consumer to closely examine the credit report and make the necessary corrections – either to the report in the case of mistakes, or to behavior.

Some have said that a generic notice provided to all consumers at or around the time of application, which informs consumers that negative information included on their credit report may affect the costs or terms of credit will satisfy the requirements of the new risk-based pricing rule. This interpretation is wrong. Both the clear language of the statute and Congressional intent require that the risk-based pricing notice *only* be sent to consumers who are provided less favorable credit as the result of their credit reports. A generic notice sent to all consumers who apply for credit is a very different requirement and would not meet either the statutory requirements or Congressional goals for the new notice.

The clear order of events contemplated by the statute is –

1) the credit *report is used;*
2) a credit *decision is made* causing the consumer to receive less favorable terms of credit;
3) then – and only then – does the statute require a risk based pricing notice to be sent to the borrower.

This is evident from the statutory language:

> (h) Duties of Users in Certain Credit Transactions. –
>
> (1) In General . – Subject to rules prescribed as provided in paragraph (6), *if any person* ***uses*** *a consumer report* in connection with an application for, or a grant, extension, or other *provision of, credit* 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, *based in* whole or part on a consumer report, *the person shall provide* an oral, written, or electronic notice to the consumer in the form and manner required by regulations prescribed in accordance with this subsection.[1] (Emphasis added.)

Senator Sarbanes was quite clear that this notice is to be triggered by the occurrence of a specific event – the provision of less than favorable credit based on the credit report – in his comments on the Conference Report:

> This legislation will also add a new provision to the FCRA that *would provide consumers with a notice when they receive less favorable credit terms*, based on their credit report. . . . .[T]he notice, by its very logic, *must be given after the terms of the offer have been set* based in whole or in part on the credit report. The notice should be provided as early as practicable in the transaction after the terms have been set.[2]

It makes no sense for every consumer to receive a notice every time a credit application is made. That timing would defeat the purposes of the new requirement: it would not inform consumers of the consequences to them of the particular credit problems reported in their credit report, which is the primary purpose of the risk-based pricing notice. This is the *teachable moment* – the moment that consumers have a special impetus to obtain their credit report, check it for errors, or note how they can improve their credit status in the future. Without this consequence, this important impetus to pay attention to one's credit report is missed. The events that trigger the risk-based pricing notice must be consumer specific; only if the particular consumer is offered less favorable credit – according to the standard set out in the Act – should the notice be sent.

In support for the generic educational notice to be sent to all upon application, some have asserted that it would be too late for consumers to receive notice once there is a pricing event and

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[1] 15 U.S.C. § 1681m(h)(1).
[2] Sen. Sarbanes' statement on FACT Act, Cong. Rec. S15806-15807, Nov. 24, 2003.

that consumers would be unable to fix the problem in their credit reports that caused the higher charges. They argue that this generic notice would provide a benefit by informing consumers before the credit decision is made that the information on their report can cost them money. While we agree that education of consumers is an important goal of FACTA (and several provisions in the Act go to great length to provide support for educational initiatives), [3] we are sure that this type of generic education effort is not what is required by the new statutory requirement for a risk-based pricing notice, and was not intended to be by Congress.

It should be noted that if the regulators believe a generic notice to all consumers at application is appropriate, this can be provided *in addition* to the specific notice triggered by the negative credit decision. However, this generic notice, by itself, will not satisfy the statutory requirements.

Notice Triggers a *New* Free Credit Report

Some have also said that the new risk-based pricing rule does not provide a *new* right to a free credit report. Yet, the plain language of the new provisions show the congressional intent that consumers have a *new* right to a free report triggered solely by the receipt of a risk-based pricing notice:

> (B) CONTENT AND DELIVERY OF NOTICE – A notice under this subsection, shall at a minimum –
>
> (A) include a statement informing the consumer that the terms offered to the consumer are set based on information from a consumer report;
>
> (B) identify the consumer reporting agency furnishing the report;
>
> (C) **include a statement informing the consumer that the consumer may obtain a copy of a consumer report from that consumer reporting agency without charge;** . . . .[4]

This statutory language shows that the credit report to be provided as the result of the risk-based pricing notice is *new*. This is evident because 1) there is no cross reference to that section of the Fair Credit Reporting Act that otherwise requires a free report to be provided to consumers, and 2) the language tracks the same requirement for the adverse action notice in another subsection of the same section (15 U.S.C. 1681m(a)(3)(A)).

Requiring credit reporting agencies to provide free reports when consumers are subjected to risk-based pricing is consistent with the goal of providing consumers with free reports when subjected to adverse action notices. According to former FTC chairman Timothy Muris –

> Adverse action notices are a critical first step in the "self help" system for correcting inaccuracies in the consumer reporting system. Consumers are in the best position to know whether the information in their consumer report is accurate. The adverse action notice informs them that the reason for denial was

[3] For example, the GAO study on what consumers know; the creation of the Financial Literacy Commission; the FTC publication of consumer rights, and the expansion of rights to free reports.
[4] 15 U.S.C. § 1681m(h)(6).

based, at least in part, on the report. With the notice, consumers have specific incentives to correct inaccurate data.[5]

A risk-based pricing notice without a right to a free report will frustrate this purpose. By including the "without charge" language, Congress facilitated this vital consumer first step of "self-help."

We hope that the Federal Reserve Board and the Federal Trade Commission will abide the specific and implicit intent of the new risk-based pricing notice and adopt risk-based pricing regulations that ensure that notice is both meaningful to consumers and triggers a new, free credit report. We have many other comments and suggestions on the issues raised by the risk-based pricing notice requirements and we look forward to discussing our views with you in the future.

Sincerely,

Margot Saunders
National Consumer Law Center

Travis Plunkett
Consumer Federation of America

Gail Hillebrand
Consumers Union

Ken McEldowney
Consumer Action

Ed Mierzwinski
U.S. Public Interest Research Group

Beth Givens
Privacy Rights Clearinghouse

Ira Rheingold
National Association of Consumer Advocates

Tamara Draut
Demos

cc: Adrienne Hurt, Asst. Dir. for Reg., Consumer and Comm. Affairs Div., FRB (via email)
Joel Winston, Associate Dir. for Financial Practices, FTC (via email)

[5] Prepared Statement of the Federal Trade Commission, Chairman Timothy J. Muris, Before the House Committee on Financial Services (July 9, 2003).