



Automobile Dealers Association of Indiana, Inc.

BULLETIN

Bulletin #10-02 – December 3, 2010

RISK-BASED PRICING RULE TAKES EFFECT JANUARY 1, 2011

The Risk-Based Pricing Rule (RBPR) arises out of Section 311 of the Fair and Accurate Credit Transactions Act of 2003 (FACT Act) and was jointly issued by the Board of Governors of the Federal Reserve and Federal Trade Commission. Commencing January 1, 2011, most dealers that obtain credit reports and extend credit to consumers must provide a new notice, known as a "Risk-Based Pricing Notice" (RBP Notice), to consumers who receive credit from them but on credit terms that are less favorable than the terms received by a "substantial proportion" of their other credit customers. This notice is different from an Adverse Action Notice, as an Adverse Action Notice is provided when credit is not extended on substantially the same terms as was requested by the consumer.

Instead of issuing the RBP Notice, dealers can issue an alternative notice, known as a "Credit Score Disclosure Exception Notice" (Exception Notice) to *all* of their consumer credit applicants; regardless of whether or not credit is ultimately extended. Consequently, a credit applicant that was ultimately turned down would receive both the Exception Notice and an Adverse Action Notice. ***Issuance of the Exception Notice is less onerous than issuance of the RBP Notice and it is recommended that dealers issue Exception Notices as opposed to RBP Notices.*** In multi-party credit transactions, such as a typical transaction where a dealership enters into the retail installment sales contract and subsequently assigns the contract to a finance company, the party to whom the credit obligation is initially payable, the dealership, is responsible for issuing the RBP or Exception Notice. ***The RBPN does not apply to lease transactions or the extension of credit to a business.***

A dealer must comply with the RBPN if it (1) obtains credit reports and (2) engages in "risk-based pricing." A dealer using 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 then setting the annual percentage rate, based in part on the "buy rate," is considered to engage in "risk-based pricing." Likewise, dealers who engage in "buy here pay here" transactions are also considered to engage in "risk-based pricing."

The Exception Notice generally must be provided to ***every consumer who applies for credit regardless of whether or not credit is extended.*** If two consumers apply jointly for credit, a separate Exception Notice must be provided to each credit applicant; which only includes the credit score for that applicant and not the credit score of the joint applicant. An exception notice is not required for guarantors or co-signers who are not applying for credit but rather are only assuming liability for those who are.

An exception notice must contain the following information:

- The consumer's current credit score;
- The date on which the credit score was created;
- The name of the credit reporting agency or other person that provided the score;
- The range of possible credit scores in the credit scoring model used to generate the credit score;
- And either: a bar graph that breaks down the range of possible credit scores into at least six bars with each bar indicating the percentage of consumers with credit scores that fall within the range of scores for that bar, or a clear statement indicating how the consumer's credit score compares to other consumers i.e. "Your credit score ranks higher than ___% of U.S. consumers."

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Dealers are *not* expected to prepare their own bar graph or the alternative credit score comparison statement. It is expected that this information will be obtained from the credit reporting agency from which the credit score is obtained. Consequently, dealers should consult with the company from which they derive credit scores to obtain this information. The exception notice must be provided to consumer credit applicants “as soon as reasonable practicable after the credit score has been obtained, but in any event at or before consummation in the case of closed-end credit. ...” Dealers should keep a copy of the notice given to the customer for its records.

In some instances, dealers may find that a credit score is unavailable from a credit reporting agency for a particular customer. In this instance, dealers are permitted to issue an alternate type of Exception Notice which is similar to the Exception Notice discussed above, *but does not contain the consumer’s credit score or the information that puts it in context*. Model disclosure forms for both types of Exception Notices have been prepared by NADA.

Section 311 of the FACT Act contains a “safe harbor” that provides that creditors will not be liable for failing to perform the duties it imposes if, at the time of failure, the creditor maintained *reasonable compliance policies and procedures*. Dealers should consult their legal counsel regarding the preparation of the proper compliance policy. Failure to comply with the RBPR can lead to penalties of \$3,500 for each “knowing” violation and increased penalties of up to \$16,000 for future violations arising out of repeated failures to comply with the rule. NADA will be publishing a comprehensive guide on compliance in the near future.

Should you have any questions regarding compliance, please contact Marty Murphy, ADAI EVP, at (317) 635-1441 or (800) 872-0363 or email: marty@adai-inc.org.