ABA Staff Analysis: Credit Score Exception Notices

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There have been reports that some vendors, service providers and even credit reporting agencies are telling banks that if they obtain a credit score or credit report they must provide a Credit Score Exception notice to ALL loan applicants, even if the bank does not price for risk or use that score/report to price its loans. We disagree.

A risk-based pricing notice or credit score exception notice is only required if the creditor uses a credit report (or credit score) to determine a material term, i.e., the APR in most cases. Of course, for mortgage loans, a separate provision applies which requires that all mortgage applicants receive a credit score, though the additional information required under the credit score exception or risk-based pricing notice is only required if risk-based pricing is involved.

The Final Rule-Subpart H – Duties of Users Regarding Risk-Based Pricing section .70 provides that:

“This subpart applies to any person that both

(i) Uses a consumer report in connection with an application . . . of credit . . . that is primarily for personal, family, or household purposes; and

(ii) Based in whole or in part on the consumer reports, grants extends, or otherwise provides credit to the 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.” (Emphasis added.)

Thus, neither the risk-based pricing notice nor the credit score exception notice applies if the creditor does not price based on risk. Merely obtaining the credit report to verify creditworthiness (that is, decide whether to grant the loan) does not meet this standard unless that report is used to set the terms of the credit.

The purpose of the risk-based pricing rules are to inform customers about the impact their credit report and/or credit score has on the pricing of a loan product for which they applied. It is the USE of the credit report for the purpose of risk-based pricing that triggers the notice. In fact, the model Credit Score Exception Notice wording includes under the heading “How we use your credit score” the comment that the credit score may impact the price of credit, which is not accurate for those lenders who do not risk base price. This may misinform and confuse the applicant.

According to the Supplementary Information to the Final Rule:

Thus, the final rules retain the requirement that in order to use these exceptions to the risk-based pricing disclosure requirements, a person must provide an exception notice to every consumer requesting an extension of credit for a product for which the person uses risk-based pricing, even those who would not otherwise receive a risk-based pricing notice.” (Emphasis added.)

The Interagency exam procedures also support the view that if the creditor doesn’t use credit to price a loan, there is no notice requirement. On p. 18 or the Examination Procedures

1. Determine whether the financial institution uses consumer report information in consumer credit decisions.

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If yes, determine whether the institution uses such information to provide credit on terms that are “materially less favorable” than the most favorable material terms available to a substantial proportion of its consumers. Relevant factors in determining the significance of differences in the cost of credit include the type of credit product, the term of the credit extension, and the extent of the difference.

If “yes,” the financial institution is subject to the risk-based pricing regulations.

To illustrate:

Bank A does not base its rate on risk. The bank has a rate sheet and everyone who is approved for credit, regardless of their score, receives the posted rate. The bank uses credit reports and scores, but only for the purpose of establishing whether an applicant gets a loan - not for determining the loan pricing. If the bank makes a rate exception, that exception is based on the total customer relationship- not the customer’s credit. The bank is not required to provide a risk-based pricing notice or a credit score exception notice.

Bank B prices its mortgage loans based on risks, but applies the same rate to all applicants of other types of credit such as installment loans or overdraft lines of credit. The bank must provide the Credit Score Exception Notice for its mortgage products, but not for its other credit products. (Note, however, that if a bank does risk-base price a particular product and uses the Credit Score Exception notice, it must send that notice to all applicants for that product, even if they would receive the best rate the bank has available.)

Bank C risk-rates every loan product it offers. This bank has chosen to use the Credit Score Exception notice and must therefore send the notice to all applicants for credit unless one of the other exceptions applies.

In conclusion, there is no requirement for the bank to provide either a risk based pricing notice or the Credit Score Exception notice when the bank does not utilize risk-based pricing, nor must a bank provide a Credit Score Exception notice for all loan products when it only utilizes this type of pricing on one or two products. If the bank risk-based prices a loan product or products and uses the credit score exception, then it must provide the exception notice to all applicants for those particular products (except those it declines.) If a bank does not risk price, there is no notice requirement.

Questions? Contact Nessa Feddis or Leslie Callaway for more information.

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