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VIEWPOINT

Creditor's Guide to New Pricing Rules

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As the lending industry gears up to meet new regulations on risk-based pricing, creditors face critical choices.

Starting Jan. 1, the Federal Trade Commission and the Federal Reserve Board have mandated that lenders provide consumers with a risk-based-pricing notice when a company grants credit on "material terms that are materially less favorable than the most favorable terms available to a substantial proportion of the consumers." Or lenders can choose to use the credit score disclosure exception by committing to provide all applicants with a special notice that contains the consumer's credit score as well as additional information about credit scores.

The method lenders choose likely will be based on the needs of different business lines within their organizations and such factors as ease of complying, determining which customers should receive a notice, incremental costs, system integration and delivery considerations.

Targeting only those who require notification: The risk-based-pricing rule requires compliance by any company that uses a credit report or score in connection with a credit decision.

For lenders that would like to minimize costs, use a custom score when decisioning, or closely monitor scorecard performance, a risk-based-pricing notice may be the preferred option.

The notice must be provided to a specific segment of consumers prior to acceptance of credit terms. Therefore, it will be an option that manages costs and reduces the volume of ongoing consumer disclosures. The FTC and the Fed have provided a model form template that reduces compliance concerns.

Lenders that choose this route will need to determine which consumers to issue the notice to by using methods outlined by the agencies, such as the direct comparison, tier pricing or credit score proxy methods. Many lenders closely manage their portfolio risk and profitability through regular portfolio review and should have minimal issues with incorporating the risk-based-pricing notice into current consumer disclosure procedures.

Taking a blanket approach: To meet the new FTC and Fed rules, creditors such as banks, mortgage and utility companies, auto lenders, and retailers will have the option of using the credit score disclosure exception to communicate with all borrowers, which eliminates the need to determine who is to receive a notice and is perceived by some as less complicated to execute and comply with. Lenders that take advantage of this standardized approach will have to provide consumers with the current credit score used in setting the material terms of credit, as well as a national score distribution.

Providing this information has the added benefit of educating consumers on the effect of credit reports on the pricing of credit. Showing borrowers how they compare with the rest of the U.S. population conveys a clear message on the importance of maintaining an unblemished credit record.

In addition, because consumers also are informed about which reporting agency provided the score, they can choose to obtain a free credit report from that company to see if there might be actions they can pursue to correct or repair their score.

While avoiding the more complicated calculation methods required by the risk-based-pricing notice option, choosing the credit score disclosure exception does have cost implications for lenders, such as incremental expenses related to coding resources, technology integration and delivery costs.

While the January deadline is still months away, creditors must begin their preparations for compliance with the new regulation. Lenders should begin evaluating their underwriting processes and understanding the constraints of their resources and technology to best determine which method will ensure effective and appropriate compliance with the rules. Depending on the complexity of each business, planning and implementation timetables could be quite involved.

Creditors will need to decide which consumer reporting agency they are going to work with to provide credit score information. Creditors should consider several factors in evaluating which provider to choose. To ensure clear and concise consumer communications, the use of an easy-to-understand score, such as VantageScore, can help consumers gain valuable insight into the basis for their credit score and the weight put on various behaviors used in calculating that score.

It is also important to remember that agencies will serve an important partnership role in educating consumers, helping to address their concerns and building an understanding about the full spectrum of credit reporting and credit scoring.

Once lenders determine their compliance methodology, bureaus can assist them in determining appropriate risk-based-pricing tiers, create score distributions, provide credit score disclosure letters and perform portfolio scorecard validations to help execute on regulatory compliance. As creditors consider how best to meet these new mandates, bureaus are working to provide the tools and support needed to seamlessly comply with the FTC and Fed requirements.

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