

May 17, 2004

Jenna B. Taub, Esq.
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8712 W. Dodge Rd., Suite 400
Omaha, NE 68114

Re: Risk-Based Credit Card Accounts.

Dear Ms. Taub:

You have asked if a federal credit union (FCU) may establish different interest rates for member credit card accounts based on differences in credit scores. If that is permissible, you have also asked if an FCU must disclose that it bases its rate determinations on those differences. An FCU may establish a different rate structure for its members based upon their credit scores. While current law does not require that an FCU disclose the basis for its rate determinations, FCUs using risk-based pricing will have additional disclosure obligations that become effective in December 2004.

A risk-based pricing model enables a credit union to make credit cards available to more of its members, including those with less-than-perfect credit histories. Inevitably, it will result in some members having more expensive credit than others. Nothing in either the Federal Credit Union Act or in NCUA's regulations prohibits an FCU from offering a credit card program in which it determines rates based on the credit profile of the member.

An FCU must base its pricing determinations on evaluation of legitimate credit risk and not on any discriminatory basis prohibited by the Equal Credit Opportunity Act. 15 U.S.C. §§1691 et seq. We also note that risk-based pricing means that members will not know the rate for which they qualify until after the FCU has approved an application and established a card account in the member's name. Potentially, this can have an adverse impact on the applicant's credit score, since an applicant may need to submit numerous applications for credit to find a lender offering an affordable rate. Consumer reporting agencies may consider a substantial number of credit applications to be a negative factor in their calculation of a credit score. We recommend that the FCU take some affirmative steps to assure that its members understand this. The Truth in Lending Act (TILA), as implemented by Regulation Z, is the primary federal law that governs credit cards. 15 U.S.C. §§1601 et seq; 12 C.F.R. Part 226. TILA requires that lenders provide consumers with disclosures about the costs and terms of a credit card on or with a solicitation or application, at account opening before the first transaction, and with each periodic billing statement. 12 C.F.R. §226.5(b). The intent of these requirements is to assure that consumers receive key cost information about credit and charge cards early enough to have the opportunity to comparison shop. You represent that the FCU is disclosing the available range of annual percentage rates (APR) in its application form, which TILA and Regulation Z do require. 15 U.S.C. §1637(c); 12 C.F.R. §226.5a(b)(1). We do not interpret TILA or Regulation Z to require an FCU, in the context of a risk-based pricing program, to notify applicants that the APR offered to them will be determined based upon their credit score.

Recent amendments to the federal Fair Credit Reporting Act (FCRA) will impose additional disclosure requirements on creditors using risk-based pricing models involving a range of possible rates. Fair and Accurate Credit Transactions Act of 2003, Pub. L. No. 108-159, §311,117 Stat. 1952, 1988 (FACTA). Effective December 2004, FACTA will require a risk-based pricing notice if a lender approves an application for credit but offers terms to the applicant that are "materially less favorable than the most favorable terms available to a substantial proportion of consumers" obtaining credit from or through that lender. *Id.* The notice must explain that the lender is basing its terms on information in a credit report. The notice must identify the consumer reporting agency that provided the credit report, including contact information, and state the consumer can request a free copy of the report. *Id.*

FACTA requires a lender to give the risk-based pricing notice at the time of application or at the time of communication of the approval. This notice may be given orally, in writing or electronically. The FCU need not provide a risk-based pricing notice if the member applied for the specific material terms the FCU offered, or if FCRA otherwise requires the FCU to provide an adverse action notice. The FCU also need not provide the notice to members who have qualified for its best offered rate. *Id.* FACTA directs the Federal Trade Commission (FTC) and the Federal Reserve Board (FRB) to prepare regulations implementing these requirements, including clarification of the meaning of certain terms and development of a model notice. We anticipate the FTC and the FRB will issue final regulations before the law goes into effect in December 2004.

In the meantime, you may find additional useful guidance on risk-based lending programs, including an expansive discussion of fair lending and anti-discrimination considerations, in NCUA's Letter to Credit Unions No. 174, dated August 1995, available on our website.

Sincerely,

Sheila A. Albin
Associate General Counsel

OGC/RPK:bhs
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