# Federal Credit Score Disclosure

Minnesota Automobile Dealers Association

The Federal Trade Commission Risk Based Pricing Rule was effective January 1, 2011. The Rule requires creditors — including car and light truck dealers — to provide a Disclosure to consumers who receive credit terms less favorable than those granted to other consumers. The Disclosure explains that they received less favorable terms because of negative information in their credit report.

The Rule applies when a dealer "uses" a credit report to grant, extend, or otherwise provide credit to a consumer on terms that are materially less favorable than the most favorable terms available to a substantial proportion of their consumer customers.

The Rule applies only to consumer credit customers. Consumer lease customers are excluded.

The Rule does not apply to business customers.

The Rule offers special treatment for dealers. Instead of dividing their credit applicants as described below, they may elect to provide a Credit Score Disclosure to all of their consumer credit applicants who are offered financing.

**General Rule For Most Creditors.** Most creditors are required to divide their credit applicants into two credit risk groups. The top 40% of applicants are the "good" risks. The lower 60% are the "poorer" risks. Only the lower group receives a Risk Based Pricing Disclosure. The problem: Which customer falls into which group?

The Rule offers creditors a couple of alternatives. First, they may elect to select a representative sample of their completed credit transactions from the last two years. The goal is to determine a cutoff credit score at which approximately 40 percent of customers have higher credit scores and approximately 60 percent have lower credit scores. The creditor then gives a Risk Based Pricing Disclosure to new applicants with credit scores falling into the lower group.

Under the alternative "Credit Tier" method, credit applicants are tiered based on their credit scores. Every applicant whose credit score falls outside of the top tier must be given a Risk Based Pricing Disclosure unless the creditor has five or more tiers. If there are five or more tiers, a Disclosure is required for customers who fall outside the top two tiers.

Both of these methods are very difficult for dealers.

**Dealer Exception Notice – Credit Score Disclosure.** During the 6-year rulemaking process, the National Automobile Dealers Association successfully lobbied the Federal Trade Commission for a special procedure for dealers. The final Rule allows dealers who offer typical installment sales financing to comply by providing a written Credit Score Disclosure to all consumers who apply for and are offered credit. This avoids the need to identify a subset of customers to whom a Disclosure must be provided.

The Credit Score Disclosure must include the consumer's credit score along with information to put the score in context. The contextual material must include either a bar graph that breaks down the range of possible credit scores or a clear statement indicating how the consumer's credit score compares to other consumers.

The Credit Score Disclosure also must contain the name of the consumer credit reporting agency or other entity that provided the score, the date the credit score was created, and certain statements intended to educate the consumer about credit reports, credit scores and how the consumer may obtain the free annual credit report to which all consumers are entitled.

**Preparing the Credit Score Disclosure.** The Rule sets out a model form. However, because of the contextual disclosures that must be provided along with the credit score, the only practical way to prepare it is through software or forms provided by a dealer's credit report provider.

## Q & A

1. Which dealers have to concern themselves with this Rule?

   All dealers who accept credit applications and sell vehicles to consumers using a retail installment sales contract.

2. We're a heavy duty truck dealer. Do we have to comply?

   No, the Rule does not apply to commercial transactions.

3. Will most dealers who use credit reports take advantage of the Credit Score Disclosure alternative instead of dividing their credit customers into two groups and providing the "lower" 60% a notice?

   Yes. We believe all dealers will adopt the Credit Score Disclosure method.

4. What does the Credit Score Disclosure look like?

   Here's a link to the Model Form suggested by the Federal Trade Commission. In practice, the disclosure form will need to be individually tailored for each customer.

5. Can we order Credit Score Disclosure forms from MADA?

   No. Because the form must be individually tailored, you'll have to work with your vendor – DealerTrack, RouteOne, etc. They are prepared to generate the Credit Score Disclosure form that you need.

6. We routinely pull bureaus. We can print off the Credit Score Disclosure from DealerTrack. Who gets Disclosure and when?

In general, a Disclosure is required whenever you're willing to offer financing to a credit applicant. If the customer is approved, a Disclosure is required "as soon as reasonably practicable after the credit score has been obtained, but in any event at or before consummation" of the transaction.

7. So, following up, we could wait until F&I to give the Disclosure?

   In many cases, yes. But there will be some instances where you have a customer approved, but a deal is never completed. Maybe you lose the customer to a competitor. In these cases, when the customer is approved for financing – even if they don't go through with a deal – a Disclosure is required. You should mail one out.

8. What if the application is over the phone or over the Internet? We pull a bureau and are able to offer financing to the customer. Do we need a Disclosure?

   Yes. If you pull a bureau and have the customer approved, a Credit Score Disclosure is required.

9. Can we email the Disclosure?

   The Disclosure must be given in "writing." It can be issued electronically only according to the Federal E-Sign Act.

10. What if we can't get the customer approved?

    If a dealer issues an Adverse Action Notice, then no Credit Score Disclosure is required.

11. We run bureaus on both a husband and wife? Two Disclosures?

    Yes. One for each.

12. Should we keep a signed copy of the Disclosure in our deal?

    The model form doesn't have a signature line. The law doesn't require an acknowledgment. It should be sufficient to have an administrative program in place to provide the Disclosure as required.

13. Following up…What if a customer claims he never received a Disclosure? How will we prove we gave him one?

    The law provides no right of civil action to a customer. In other words a customer can't sue you for violating the Rule. The Federal Trade Commission has enforcement authority but won't look for isolated missteps. Instead the FTC will likely look for reasonable administrative steps a dealer is taking to comply with the Rule.

14. We're a small dealer. We don't pull bureaus. Do we have any obligations under the Rule?

    Yes. MADA had been advising dealers that the answer was "No" until a Federal Court of Appeals dismissed a National Automobile Dealers Association lawsuit against the Federal Trade Commission on March 7, 2013.

    In 2011 the FTC issued a written interpretation that in the typical installment sales transaction, the disclosure obligation was triggered <u>even if the dealer never obtained a consumer credit report</u>, because the dealer has "used a credit report in connection with an application for credit because [the dealer] initiated the request that caused the financing source to obtain the consumer report…"

    NADA went to Federal Court and challenged the bootstrapping FTC logic. NADA argued that a dealer can't be considered to be "using" a credit report that it never sees. It furthermore questioned the feasibility of a dealer obtaining credit score information from a lender.

    NADA lost in Washington D.C. District Court and appealed. The appeal has now also failed.

    This final ruling means that dealers are required to generate a Credit Score Disclosure for all consumer customers approved for and offered vehicle financing. That may mean dealers pulling a bureau when they otherwise wouldn't - perhaps to the detriment of their customers' credit rating.

15. We have an arrangement with our local credit union. We initiate direct loan paper on their behalf. There's no installment sales contract. Instead the note is between the credit union as creditor and the customer. Is a Credit Score Disclosure required?

    Yes, but the Rule would apply to the credit union – not the dealer. If the credit union is the initial creditor and "uses" a consumer credit reports, the credit union has the obligation to comply with the disclosure requirements. The regulation allows the initial creditor (in this case the credit union) to use the dealer as the conduit to fulfill its obligation to provide a Risk Based Pricing or Credit Score Disclosure.

16. We have more questions. Are there other resources?

    <u>Here's the official publication.</u> The text of the Rule.

    If you're a MADA member, call Jim Schutjer at 651-291-2400