Capital One Financial Corporation
1680 Capital One Drive
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August 26, 2008

Ms. Jennifer J. Johnson
Secretary
Board of Governors
Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551
regs.comments@federalreserve.gov

Federal Trade Commission
Office of the Secretary
Room H-135 (Annex M)
600 Pennsylvania Ave., NW
Washington, DC 20580
https://secure.commentworks.com/ftc-RiskBasedPricing

**Re: FACT Act Proposed Risk-Based Pricing Rule**
**Board (Docket No. R-1316); FTC (Project No. R411009)**

Ladies and Gentlemen:

Capital One Financial Corporation ("Capital One") is pleased to submit comments to the Federal Reserve Board ("Board") and Federal Trade Commission (collectively, "Agencies") on the proposed Fair Credit Reporting Risk-Based Pricing Regulations under Section 311 of the Fair and Accurate Credit Transactions Act of 2003 ("FACT Act").[1]

Capital One Financial Corporation (www.capitalone.com) is a financial holding company whose subsidiaries collectively had $92.4 billion in deposits and $147.2 billion in managed loans outstanding as of June 30, 2008. Headquartered in McLean, VA, Capital One has 740 locations in New York, New Jersey, Connecticut, Texas and

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[1] 73 Fed. Reg. 28966 (May 19, 2008). References in this comment letter to the Board's proposed rule in 12 CFR part 222 also apply to the Federal Trade Commission's ("FTC") proposed rule in 16 CFR parts 640 and 698.

Louisiana. It is a diversified financial services company whose principal subsidiaries, Capital One, N.A., Capital One Bank (USA), N. A., and Capital One Auto Finance, Inc., offer a broad spectrum of financial products and services to consumers, small businesses and commercial clients. A Fortune 500 company, Capital One trades on the New York Stock Exchange under the symbol "COF" and is included in the S&P 100 index.

Capital One commends the Agencies on proposing regulations that simplify an extraordinarily challenging statutory provision generally requiring lenders to provide risk-based pricing notices to consumers.[2] As we have stated publicly and as evidenced by our business practices, Capital One believes in empowering our customers. Thus we support the Agencies' goal of encouraging consumers to "check their consumer reports for accuracy and correct any inaccurate information."[3] We believe this empowers consumers to take control of their financial affairs by being knowledgeable of the contents of their credit files and correcting any inaccuracies in them.

We respectfully offer the following comments.

**The FACT Act contemplates and the rule should require or permit a notice provided at application.**

Capital One recognizes that the proposed rule is the result of significant outreach efforts and discussions between the Agencies and interested parties and that certain approaches have been carefully considered. We applaud that effort but are concerned about the effectiveness of the risk-based pricing notice under the approach proposed by the Agencies.

The Agencies' propose requiring a risk-based pricing notice that tells the consumer that he or she may not have received the most favorable credit terms.[4] To encourage consumers to check their credit report for inaccuracies prior to becoming obligated on the loan, the Agencies require that the notice be provided at or after a credit decision has been communicated but before loan consummation on a closed-end loan or the first transaction on an open-end credit plan.[5] The general rule is that such notice must be

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[2] Section 311 of the FACT Act amends the Fair Credit Reporting Act ("FCRA") to require a risk-based pricing notice to be given when

> any person uses a consumer report in connection with an application for, or a grant, extension, or other provision of, credit on material terms that are materially less favorable than the most favorable terms available to a substantial proportion of consumers from or through that person, based in whole or in part on a consumer report....

FCRA §615(h)(1).

[3] 73 Fed. Reg. at 28967.

[4] Proposed §222.73(a)(1).

[5] Proposed §222.73(c).

given to any consumer who received materially less favorable terms than the most favorable material terms available to a substantial proportion of consumers.[6] The Agencies define "material terms" as the annual percentage rate ("APR") disclosed in Regulation Z disclosures.[7] However, the Agencies understand that it is not operationally feasible for most lenders to conduct direct case-by-case comparison of the terms offered to each consumer with the terms offered to other consumers in similar transactions. As such, the Agencies propose a credit score proxy method and a tiered pricing proxy method. The two methods require that notices must be given to consumers 1) whose credit scores fall in the bottom 60 percent of the credit scores of the lender's consumers who received credit offers; or 2) who fall in the lender's lower pricing tiers.[8] The proposed rule details how to calculate the cut-off credit score under the credit score proxy method[9] and how to determine the cut-off pricing tier under the tiered pricing method.[10]

Capital One commends the Agencies for offering creative alternatives to the default rule requiring direct comparison of the material terms. However, we are concerned that the proposed timing of the notices is too late for consumers to correct any possible error in their credit files in time to impact their application for credit. The Agencies state that they "believe that the notice is likely to have the most utility if it is provided early enough in a transaction that it encourages a consumer to check his or her consumer report for inaccuracies."[11] However, by requiring that the notice be provided after the credit terms have been set, the Agencies do not give consumers sufficient opportunity to check their consumer report for inaccuracies, and fix any inaccuracies or explain the inaccuracies to the lender in time to impact the underwriting and credit terms.

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[6] Proposed §222.72(b).

[7] For open-end credit, the material term is the APR required to be disclosed at account opening excluding any temporary initial rate or penalty rate. *See* proposed §222.71(i)(1)(i). For closed-end credit, the material term is the APR required to be disclosed before consummation of the loan. *See* proposed §222.71(i)(2).

[8] Proposed §222.72(b)(1) and (2).

[9] The proposed rule on the credit score proxy method explains how to calculate the cut-off credit score based on all the lender's consumers, a representative sample of consumers, or a secondary source; how to recalculate the cut-off score in one or two years depending on the circumstances; how to determine the cut-off score if the lender uses two or more credit scores to make a credit decision; and how to handle the lack of consumer credit scores. *See* proposed §222.72(b)(1).

[10] The proposed rule on the tiered pricing method explains how to determine the cut-off tier in various situations. If there are four or fewer pricing tiers, the cut-off tier is any tier below the best tier. If there are five or more pricing tiers, the cut-off tier is below the two best tiers and any other tier that, together with the best tiers, comprise no less than the top 30 percent but no more than the top 40 percent of the total number of tiers. *See* proposed §222.72(b)(2).

[11] 73 Fed. Reg. at 28979.

To address this, the Agencies should permit the notice to be provided at application to all consumers. Such a notice would give consumers time to review their credit files and correct any errors before the credit terms are set. This notice could appropriately be given to all consumers because it alerts consumers that their credit information will be used in the underwriting process, encourages them to check their credit files for any inaccuracies, and explains how to correct inaccuracies or notify the lender prior to or during the underwriting of their credit application. As such, the notice at application would be more meaningful to consumers and have more impact on consumers' application for credit than the Agencies' proposed notice.

Importantly, the FCRA explicitly contemplates a notice at application to all applicants. The statute plainly states that the notice "may be provided at the time of application."[12] As such, the FCRA intended not only that the notice be provided at application but that it would be given to all consumers since it is not possible to differentiate among consumers at application. This is consistent with legislative history. A section-by-section analysis of the proposed law presented by Representative Oxley on behalf of Representative Bachus, who introduced the FACT Act as legislation and presided over a series of hearings that laid the groundwork for the legislation stated that "nothing in this section, however, precludes a lender from providing such a notice to all of its new credit customers."[13] The record also indicates that the law allows "flexibility in the timing of providing such notice, which can be given to the consumer at the time of application for credit."[14] Lastly, the section-by-section analysis states that "[t]he creditor is not required to tell the consumer that it has taken or may take any unfavorable action, only that it will use credit reporting information in the underwriting process."[15]

We urge the Agencies to solve the timing issue related to the current proposal and to give effect to this provision of the FCRA by either creating a default rule requiring notice be provided to all consumers at the time of application, or creating an exception to the Agencies' proposed default rule permitting notice to all consumers at application.[16]

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[12] FCRA §615(h)(2).

[13] *See* 149 Cong. Rec. E2516.

[14] *Id.*

[15] *Id.*

[16] The Agencies propose an exception to the risk-based pricing notice requirement when a lender provides the consumer with his or her credit score. Such credit score disclosure does not trigger a separate consumer right to a free consumer report. *See* proposed §222.74(d) and (e). As with the credit score disclosures, the notice at application could be interpreted to not trigger a separate consumer right to a free consumer report. Similar to the credit score disclosure, the notice at application would state that federal law gives consumers the right to obtain a free annual consumer report. *See* proposed §222.74(d)(ii)((G) and (e)(ii)((J).

**The proposed rule should be modified and clarified to identify a more meaningful population of consumers to receive notice.**

*Credit Score Proxy Method*

As discussed above, Capital One advocates notifying all applicants that their credit information will inform the terms of their credit offer and urging them to take steps to ensure the accuracy of their credit information prior to applying. But the Agencies' rule contemplates a different message that alerts consumers who have already applied that they may have been offered less favorable terms based on their credit history. Unlike the first message, which appropriately can be communicated to a broad audience, the Agencies proposal must be carefully tailored to the population for whom it is applicable.

The credit score proxy method is one of two methods to determine who should get the proposed risk-based pricing notice, a quasi-adverse action notice. This method requires that the notice be provided to any consumer whose credit scores falls within the lower 60 percent of credit scores of consumers the lender made offers to. The Agencies recognize that the credit score proxy method does not provide notice to the appropriate consumers. For example, the Agencies acknowledge that in some instances "a consumer with a credit score below the cutoff score would receive a notice even if he or she received the creditor's most favorable terms."[17] Providing notices to such consumers will result in confusion and consumer complaints. Moreover, such over-notification reduces the strength and credibility of the notice.

For these reasons, we urge the Agencies to reconsider requiring notice be sent to 60 percent of consumers for the credit score proxy method. We propose that the notice should be provided to a minority of consumers, such as less than 49 percent of consumers.

*Credit Card Rule*

The Agencies propose a special test to identify when a lender must provide notice to credit card consumers. Under this "less-than-the-best" method, when a solicitation or credit card program has multiple or a range of purchase APRs possible, a notice must be provided to the consumer if he or she does not get an offer of the best (lowest) APR.[18]

Capital One believes this is a reasonable option for determining who should get a notice. We also believe that it is the intent of the Agencies to also make the credit score proxy method and the tiered pricing proxy method available to all lenders, including credit card issuers. Indeed the Agencies use a credit card example to illustrate the credit

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[17] 73 Fed Reg. at 28974.

[18] The Agencies specify, and we agree, that the material APR is the APR for purchases. *See* proposed §222.71(i)(1)(ii).

score proxy method.[19] Nevertheless, for the avoidance of doubt, we urge the Agencies to clarify that, notwithstanding the special rule for credit cards, both the credit card proxy method and the tiered pricing methods are available as options for credit card issuers.

**The proposed exceptions to the notice requirement should be clarified so that lenders may rely on them.**

*Prescreen Exception*

Capital One applauds the Agencies for addressing the intersection of the proposed rule and prescreening, a process that begins with accessing consumer report information and ends with making a firm offer of credit to a consumer.[20] The Agencies state and we agree that consumers will not benefit from a risk-based pricing notice in connection with the prescreening process.[21]

However, the exception for prescreening does not go far enough and in fact calls into question whether other prequalification experiences, which are not prescreening under the FCRA and therefore would not qualify for the special exception, might require the notice. For example, some lenders use consumer reports to pre-qualify consumers for selected offers of credit that may later result in an application and underwriting based on a second review of consumer report information. The Board in Regulation B deems this to be an inquiry or prequalification, and not an application.[22] Requiring delivery of a notice in connection with an inquiry or prequalification would create two problems. First, it would violate the Agencies' proposed rule that a consumer should receive only one notice per extension of credit; it is possible that a notice may be triggered in response to an inquiry or prequalification and then again with the credit offer.[23] Second, notice at

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[19] Proposed §222.72(b)(1)(iv)(A).

[20] The prescreening process is outlined in FCRA §604(c).

[21] Proposed §222.74(c). Although we do not believe the FCRA risk-based pricing provision was intended to cover the use of consumer report information in connection with prescreening, we recognize that the language of the FCRA complicates the analysis. The FCRA risk-based pricing provision states that a notice may be required when "a person uses a consumer report in connection with an application for, or a grant, extension, or other provision of, credit..." FCRA §615(h)(1). In authorizing prescreening, the FCRA indirectly refers to it as a credit transaction "involving the extension of credit to, or review or collection of an account." FCRA §604(a)(3)(A) as referred to in FCRA §604(c). Thus, we support the Agencies' decision to articulate a clear prescreening exception to the risk-based pricing notice requirement.

[22] Regulation B states that a prequalification is an inquiry, and therefore not an application for credit "if the creditor evaluates specific information about the consumer and tells the consumer the loan amount, rate, and other terms of credit the consumer could qualify for under various loan programs...." However, if the creditor denies credit to the consumer based on the inquiry or prequalification, the inquiry or prequalification is deemed an application. Regulation B §202.9 comment 5.

[23] Proposed §222.75(a). The Agencies explain that they

the inquiry or prequalification stage violates the proposed timing requirement under which notice is to be provided no "earlier than the time the decision to approve the application ... is communicated to the consumer."[24] Requiring a notice in connection with an inquiry or prequalification would be prior to application, in direct contradiction to the Agencies timing rule for the notice. Therefore Capital One urges the Agencies to broaden the prescreened exception to include pre-application offers, such as responses to inquiries and prequalifications.

*Credit Score Disclosure Method*

The Agencies propose an exception to the notice requirement when the lender provides the consumer with his or her credit score.[25] As stated, Capital One commends the Agencies for offering creative alternatives and exceptions including the credit score disclosure exception. However, Capital One is concerned that absent some clarification, contractual provisions in the industry may prevent some lenders from taking full advantage of this consumer-friendly exception. Lenders' rights and obligations with respect to credit scores are set forth in contracts with the third parties who provide the scores. Some of those contracts prohibit lenders from disclosing the scores they purchase to the consumers to whom they apply, except in certain circumstances not relevant here. Congress addressed these limitations when it amended the FCRA to require disclosure of the credit scores in connection with mortgage loans. Specifically, the FCRA states that "[a]ny provision in a contract that prohibits the disclosure of a credit score by a person who makes or arranges loans or a consumer reporting agency is void."[26] Some companies in the industry have argued that the above referenced provision only voids contractual provisions that would impair the specific score disclosures required of mortgage lenders. Capital One urges the Agencies to clarify that the FCRA operates to make the credit score disclosure method available to all lenders who purchase credit scores in connection with their underwriting operations.

**Additional issues to consider.**

*Multi-Party Transactions*

The Agencies propose, and we agree, that the lender to whom the obligation is initially payable should provide the risk-based pricing notice.[27] This is appropriate and

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> do not interpret the statute as requiring the consumer to receive more than one risk-based pricing notice in connection with a single extension of credit. Moreover, the Agencies do not believe that consumers would benefit by receiving multiple notices....

73 Fed. Reg. at 28985.

[24] Proposed §222.73(c).

[25] Proposed §222.74(d) and (e).

[26] FCRA §609(g)(2)(A).
[27] Proposed §222.75(b).

logical since that is the same person that must provide the Regulation Z disclosures. It is more meaningful to consumers that the lender giving the Regulation Z disclosures containing the material terms (i.e. APR) would also give the notice alerting consumers that they may not have received the most favorable terms. In addition, as the entity responsible for providing the Regulation Z disclosures, this Regulation Z lender is in the best position to know whether the risk-based pricing notice is necessary. Lastly, since this lender is already providing consumer disclosures, the lender could easily provide the risk-based pricing notice at the same time.

*Timing of the Notice*

Capital One recommends an exception to the proposed timing requirement under which the notice for credit must be delivered before consummation or the first transaction.[28] The proposed timing requirement presents operational and privacy concerns in the context of "instant credit" in which consumers obtain credit at retail locations contemporaneous with a retail transaction.

Even if the lender has the store clerk provide the basic model notice, which involves the least amount of customization, the lender nevertheless would have the operational challenge of identifying and communicating instantaneously to the store clerk whether the consumer must get the notice. The lender cannot provide the notice to all consumers since the proposed rule does not permit over-notification.[29] Furthermore, asking the store clerk to provide a notice to the consumer in front of others may compromise the consumer's privacy because the notice implicitly identifies the consumer as having impaired credit. The alternative is to provide notice to all consumers with each consumer's credit score. But this would present the same operational challenges and even greater privacy concerns.

Additionally, in these circumstances, we believe it unlikely that the consumer would be inclined or able to validate or dispute his or her credit history until after consummation or after the first transaction. A minor delay will not materially change the consumer's ability to use the notice to improve the accuracy of his or her consumer report. Thus, Capital One proposes that for instant credit situations, lenders be permitted to deliver the risk-based pricing notice to the consumer after consummation or the first transaction.

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[28] Proposed §222.73(c).

[29] The Agencies explain that

> It would not violate the rules to provide risk-based pricing notices to some consumers who receive the most favorable terms so long as the selection of those consumers results from the proper application of either of these two [proxy] methods. Neither of these methods, however, would permit a lender to provide the notice to all consumers.

73 Fed. Reg. at 28974.

*Content of Notice*

The Agencies ask whether the model notices should use terminology that conveys to the recipient a higher probability that the terms awarded to them are less favorable. For example, the Agencies ask whether stating that the terms awarded "are likely to be" less favorable would be preferable to stating that the terms "may be" less favorable. Terminology that conveys a higher probability that the terms are less favorable will engender unnecessary confusion and therefore Capital One does not recommend it. For some lenders, the credit score proxy method may be the only feasible way to comply with the rule. However, as discussed above, the credit score proxy method may result in sending the notice to an over-inclusive group. Using terminology that conveys a high probability that the recipient received less favorable terms puts some lenders in the awkward position of either rejecting the model notices or sending a notice that may be deceptive and confusing to a population that in fact may have received the most favorable terms.

*Definition of Material Terms*

Capital One agrees that "Material Terms" is best defined as the consumer's APR and we applaud the Agencies for providing precise clarification of that term for open-end and closed-end credit. Capital One believes that introducing other monetary and non-monetary terms to the definition of "Material Terms" adds little value and significant complexity that detracts from the agencies effort to create a rule that is operationally feasible for lenders with which to comply.

*Business Credit*

Capital One agrees with the Agencies' decision to limit application of the rule to consumer credit. Even when underwritten based on consumer credit reports, the terms of a business loan rarely correlate to the strength or weakness of the consumer's credit report in the way that consumer loans do. For that reason, providing a risk-based pricing notice for a business loan would not provide significant value to consumers and could in fact send a confusing message to consumers whose business loans received less favorable terms as a result of factors unrelated to consumer credit reports. Capital One does not believe that there are any circumstances under which lenders should be required to provide notice in connection with credit primarily for business purposes.

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Capital One appreciates the opportunity to comment on the Agencies' proposed Fair Credit Reporting Risk-Based Pricing regulations under FACT Act Section 311. If you have any questions about our comments, please call me, Ducie Le, at (703) 720-2260.

Sincerely,

Minh-Duc T. Le
Assistant General Counsel, Policy Analysis