July 2011

Dodd-Frank Act Increases Disclosure Requirements for Financial Institutions and Other Businesses Which Make Decisions Based on Credit Scores

On July 15, 2011, the Federal Reserve Board ("the Board") and the Federal Trade Commission ("FTC") published final rules in the Federal Register implementing the credit score disclosure requirements contained in Section 1100F of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"). If a credit score is used to set material terms of credit or to take any type of adverse action, the Dodd-Frank Act requires disclosure of the credit score and related information to consumers in Fair Credit Reporting Act ("FCRA") notices. One of the final rules amended certain model notices in the Equal Credit Opportunity Act's ("ECOA") Regulation B, combining the adverse action notice requirements for the ECOA and the FCRA to reflect the new credit score disclosure requirements. The other rule, issued jointly with the FTC, amended Regulation V (related to fair credit reporting) to revise the content requirements for risk-based pricing notices and to add related model forms that reflect the new credit score disclosure requirements. The rules were issued before general rulemaking authority under these statutes was transferred to the Consumer Financial Protection Bureau ("CFPB"), which began formal operations on July 21, 2011.

While "adverse actions" include denials of credit and loans, as well as modifications resulting in less favorable credit or loan terms, they may also include business decisions related to non-credit or non-lending decisions (discussed further below). Prior to the Dodd-Frank Act, the FCRA required entities taking an adverse action based on a consumer report to provide an adverse action notice stating the name of the credit reporting agency that created the report and giving notice of the consumer's right to request a free credit report and dispute the accuracy of the report's content. The ECOA required creditors to provide consumers with the specific principal reason for the action taken or disclose that the applicant has the right to request the reason(s) for denial within sixty days of receipt of the bank's notification, along with the name, address, and telephone number of the person who can provide the specific reason(s) for the adverse action. Because these rules worked together, Regulation B contained certain model forms that combined the adverse action notice requirements for the ECOA and the FCRA.

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In addition to the prior mandated disclosures, under the Dodd-Frank Act, companies which use credit scores[1] to set material terms of credit or take an adverse action must also disclose the following information to consumers:

- The numerical credit score used in taking the adverse action;
- The range of possible credit scores under the model used;
- The factors that adversely affected the credit score of the consumer, which should be ranked in the order of their importance and should not exceed four factors — unless the number of credit inquiries is a factor and is not already reflected in the top four, in which case, five factors must be disclosed (*i.e.*, the top four, plus the "inquiries" factor);
- The date on which the credit score was created;
- The name of the consumer reporting agency or other person providing the score; and
- A prescribed statement explaining credit scores.

The new rules and the model forms reflect these new content requirements, and entities may take advantage of certain safe harbor provisions by using the model forms. However, it should be noted that simply providing the credit score and the key factors adversely affecting the credit score does not satisfy the requirement to provide specific reasons for the adverse action under ECOA. While they may be related, the Board believes that disclosure of both the key factors and specific reasons are necessary because an adverse action may be based on reasons unrelated to the score, such as the consumer's income, employment, or residency. It is also impermissible to wait until a consumer exercises his or her right to request specific reasons for the credit denial to provide the credit score used, if any, and additional information.

Recognizing that creditors may use a consumer report but not an actual credit score in taking adverse action, the Board allows that if no credit score is used in making the decision, then no credit score or related information needs to be included in the adverse action notice. Similarly, the Dodd-Frank Act does not require additional disclosures in the event an adverse action is taken because a consumer does not have a credit score.

[1] A "credit score" is a proprietary score developed by creditors to predict the likelihood of certain credit behaviors, including default. Under certain circumstances, some proprietary scores, such as insurance scores or scores used to predict the likelihood of false identity, may be excluded from the definition of "credit score."

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The Dodd-Frank Act did not limit the disclosure requirements to adverse action decisions related to credit. Creditors, including banks, credit unions, and credit card issuers, are clearly affected by these changes, but, in addition, the commentary to the rules makes clear that FCRA adverse action notices also apply to non-credit and non-lending decisions. Thus, if rental, employment, or insurance applications, for instance, are denied or adversely affected as a result of a credit score, the enhanced disclosure requirements apply. Similarly, utilities or others entities which charge an increased deposit as a result of a credit score also should comply with the new requirements. Note that the CFPB's jurisdiction with regard to the credit scores only applies to consumer financial products or services; so, the CFPB likely does not have jurisdiction or authority over those who arguably do not engage in consumer financial services (such as landlords, employers, or insurers), but they continue to be subject to FTC jurisdiction.

The new rules are effective 30 days after publication in the Federal Register. However, by its terms, Section 1100F of the Dodd-Frank Act was self-effectuating, and its requirements became legally effective on July 21, 2011. Thus, notices as of that date must contain the enhanced credit score disclosures.

The Dodd-Frank Act has made fundamental changes to certain aspects of the ways in which financial institutions and businesses can use credit scores, and has increased the amount and type of information which must be obtained from credit reporting agencies, potentially increasing direct and indirect costs. It is advisable for entities that use credit scores to make any sorts of decisions to engage counsel in a review of their procedures to ensure full compliance. Failure to comply may subject the entity to potential liability to consumers for actual damages, attorneys' fees, and/or punitive damages.