SCOTSMAN GUIDE

The Facts on FACTA

Along with extra legwork, the Fair and Accurate Credit Transactions Act has created opportunities for consumer satisfaction

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For the mortgage industry, the Fair and Accurate Credit Transactions Act of 2003 (FACTA) is an important piece of legislation whose impact continues to evolve.

FACTA makes many amendments to the Fair Credit Reporting Act (FCRA) and became law on Dec. 4, 2003, though many of its provisions are not yet in effect. Lawyers and industry specialists still are working through it to ensure understanding and compliance.

Among the FACTA requirements of interest to mortgage professionals are those relating to credit-score disclosures, risk-based pricing disclosures, combating identity theft and lender obligations when providing information to credit-reporting agencies. These and other requirements present new issues for mortgage brokers, as well as new opportunities.

Credit-score disclosures

A person who uses a credit score in making or arranging a loan secured by a one- to four-unit residential real property — i.e., a lender or broker — must give the consumer credit-scoring information obtained from the credit-reporting agency. The person also must provide an explanation of credit scores' role in the lender's decision, and the consumer-reporting agency's name must be disclosed. Consumer-reporting agencies must disclose similar information to consumers by request and can charge a reasonable fee for doing so.

The credit-score disclosure also must show the top four factors that adversely affected the score, in order of importance. In addition, if the number of inquiries adversely affected the credit score, a consumer-reporting agency must conspicuously state that the number of inquiries was a factor — even if it was not among the top four.

Information included in the disclosure must include the date the score was created, a range of possible scores and the name of the person who provided the credit score or the credit file on which it was based. The lender or broker is not obligated to explain a credit score in any more detail than the statute requires. Mortgage lenders and brokers should be aware that when "mortgage scores" are produced by an automated underwriting system, such scores need not be disclosed to the consumer. Only credit scores must be disclosed. This requirement took effect in December 2004.

Although this requirement imposes some burden on lenders and brokers, it also can be an "early warning" of credit problems that can be corrected in time to help the borrower receive better pricing.

Risk-based pricing notice

FACTA directs the Federal Reserve Board (FRB) and Federal Trade Commission (FTC) to issue regulations requiring a new risk-based pricing notice at application. It also is required when "any person" uses a consumer report with an offer of credit on terms that are "materially less favorable" than those offered to other consumers. In other words, the notice is necessary when a consumer is offered suboptimal credit.

The notice must identify the consumer-reporting agency that provided the credit information and state that the credit information affected the terms of the offer. A risk-based pricing notice can be provided orally, electronically or in writing. It does not replace a notice of adverse action when one is required. Instead, the new notice applies when adverse action has not taken place, such as when the consumer did not request any particular rate or accepts a counteroffer at a higher rate than requested.

The FRB and FTC have not yet proposed their rules, and it is unclear exactly what their regulations will require. Many in the mortgage-lending industry seek a generic, upfront notice that would alert all consumers to the importance of credit history in pricing. If the FRB and FTC instead required a specific notice to the

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consumer only after pricing was determined, it often would be difficult to determine if a credit offer had materially less-favorable terms. Even if the notice were provided, it could come too late in the process for consumers to shop for better credit terms. It is also unclear whether brokers will be covered by the rule or if so, how they would determine when they are offering materially less-favorable terms that trigger the notice.

Use of credit information

FACTA supplements an existing FCRA requirement that provides consumers an opt-out opportunity before a company can share consumer-report information with affiliates. FACTA does not change FCRA's restrictions for information-sharing with affiliates. But generally, it requires that the consumer be offered an opportunity to opt out before the affiliate uses any shared consumer financial information for marketing. In other words, FACTA affects the affiliate's use of shared information, not the sharing itself. There are exceptions for situations such as a pre-existing relationship between the affiliate and the consumer and affiliate services for the entity that has the relationship. Like the risk-based pricing provision, this requirement will not go into effect until rules are issued by the FTC and federal financial institutions' supervisory agencies. Proposals are pending.

Under the new provision, a consumer must have an opportunity to opt out of being used for marketing by a company with financial information obtained from an affiliate, including consumer reports and direct transaction-and-experience information. Again, the provision does not restrict sharing of transaction-and-experience information, as opposed to use of that information.

Identity theft

FACTA also creates new procedures to help reduce identity theft. They permit consumers to place an alert in their credit files. Lenders must follow special identification procedures when extending credit to someone whose credit report includes this alert. Credit-report users also must verify the identities of consumers with these alerts before making loans to them. Note that the alert already is contained in the credit report; users do not have to investigate the identity-theft claim. Failing to take the required steps exposes the report-user to liability for violating FCRA, in addition to the losses associated with an identity theft.

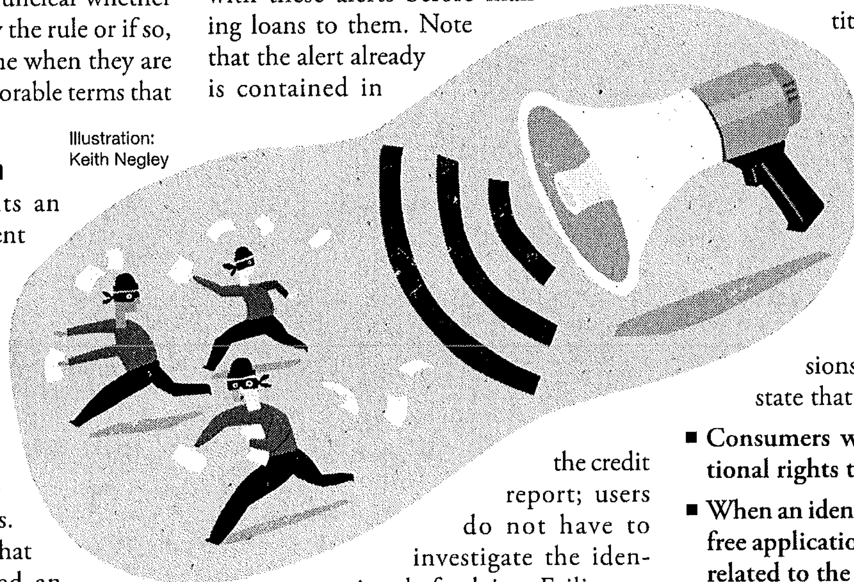

Illustration: Keith Negley

There are two levels of identity-theft alerts. Fraud alerts, which consumers can initiate by telephone, are valid for 90 days. Extended alerts, which require filing of a police or identity-theft report, can be valid for as long as seven years. The FTC also has issued rules defining "identity theft" and "identity-theft reports."

If a credit report with an alert includes a telephone number to verify the applicant's identity, the report user must call that number or take other reasonable steps to verify identity and confirm that the request is not the result of identity theft. For extended alerts, the user must contact the consumer in person, by telephone or through another reasonable contact method, designated by the consumer. Credit-report users need not follow these procedures to extend credit on existing credit lines. They must follow them, however, for requests to increase the credit limit.

FACTA's identity-theft provisions also require credit bureaus to block reports of items that were generated by an identity thief and notify the entity that furnished the blocked information. The user also can go to that entity and request a block. In either case, a police or similar identity-theft report is required. A valid request for a block implies that credit was extended to an identity thief, so a lender also should involve its fraud-prevention unit when it receives a blocking request from a credit bureau or consumer.

Other FACTA provisions addressing identity theft state that:

- **Consumers who file alerts have additional rights to free credit reports.**
- **When an identity-theft victim requests a free application and transaction records related to the theft, a user of consumer reports must provide them.**
- **Credit bureaus must alert lenders when a consumer-report request includes an address that is different from the one in the consumer's file.** The lender must then take reasonable steps to confirm the consumer's identity and determine there is no identity theft.
- **Federal regulators will issue guidelines and regulations requiring lenders to monitor and identify or flag patterns, practices or activities that would indicate identity theft or other fraud.**
- **FACTA also requires the FTC, in consultation with the federal banking agencies and the National Credit Union Association, to develop a model form and procedures for consumers to use to report identity theft to lenders and consumer-reporting agencies.** An identity-theft affidavit and sample letters, as well as explanations on when to use the

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forms to report identity theft, can be found at www.ftc.gov/bcp/conline/pubs/credit/idtheft.htm.

There is no requirement in FCRA about providing information to a credit-reporting agency. But once a lender decides, it is responsible for furnishing accurate information. The standard for the furnisher's duty for accurate information is changed from "knows or consciously avoids knowing that the information is inaccurate" to "knows or has reasonable cause to believe that the information is inaccurate." "Reasonable cause" is defined narrowly, however, to exclude situations in which the consumer is the only information source.

Pre-emption

FACTA has a degree of built-in pre-emption of state laws. It prevents the states from imposing more-onerous regulations in many areas, including those related to information-sharing among affiliates.

Before FACTA, FCRA pre-empted state law in a number of areas. But by January 2004, it would have allowed the states to enact laws that provided more consumer protection than the federal law, if the state law specified explicitly that it was meant to supplement FCRA. FACTA eliminated the states' ability to opt out of federal pre-emption beginning in 2004. In other words, the existing pre-emption provisions are now permanent.

FACTA also pre-empts state laws governing the subject areas of new provisions that it added to FCRA, including: risk-based pricing notices, credit-score disclosures (existing laws are grandfathered), annual free credit reports and other matters.

Other relevant provisions

FACTA has more provisions that impact the mortgage industry, including:

- **Annual free credit reports for consumers:** By Sept. 1, this provision will be phased in nationwide. Although increased access to credit files could generate more customer disputes for lenders, the FACTA provision also can be helpful to mortgage brokers and lenders. It helps borrowers correct problems with their files when there still is time to affect their loan eligibility.
- **Limits on the use and sharing of medical information:** These could make it more difficult for lenders to see if an applicant has the mental capacity to enter into a loan agreement. Federal banking agencies recently issued interim exceptions to these rules.
- **Use of a model notice for lenders to report negative credit information:** This applies to any financial institution as defined in the Gramm-Leach-Bliley Act; this includes any mortgage lender. The notice may be provided with a notice of default or billing statement but not with Truth in Lending Act disclosures. A lender may not report negative information until it has provided the notice.
- **Disposal of consumer-report information and records:** The FTC, federal banking agencies, the Securities and Exchange Commission and the National Credit Union Administration are required to issue "consistent and comparable" (but not joint) regulations or guidelines requiring the proper disposal of information from consumer reports. Examples of reasonable measures to dispose of consumer reports include burning, pulverizing or shredding papers containing consumer information; destruction or erasure of electronic media containing consumer information; and monitoring third parties engaged in record destruction.
- **Truncation of credit- or debit-card numbers:** Businesses may not print more than the final five digits of a credit- or debit-card number on an electronically generated point-of-sale receipt. This would appear to apply, for example, to a mortgage originator who accepts credit-card payments for appraisal and application fees. Since January, this provision has covered equipment that was in service as of Dec. 4, 2004. It covers new equipment effective Dec. 4, 2006.
- **FCRA statute of limitations extension:** FCRA lawsuits are allowed within five years of a violation. FACTA adds a discovery rule that also allows actions within two years of discovery. This rule overrules the U.S. Supreme Court decision in TRW vs. Andrews, 534 U.S. 19 (2001).
- **Federal credit and theft studies:** FACTA requires various federal agencies to study topics such as the impact of credit scoring on the availability and affordability of financial products (including the impact on minorities); the use of biometrics to prevent identity theft; and whether to tighten restrictions on the use of prescreened information.
- **Creation of a Financial Literacy and Education Commission:** FACTA creates a Financial Literacy and Education Commission to develop a strategy to increase consumer financial understanding. Agencies taking part include the U.S. Treasury, FRB, FTC and other federal banking agencies, plus other appointed officials.

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FACTA is a sweeping revision of FCRA that imposes many new obligations on mortgage lenders and brokers.

Although many of these requirements create new compliance burdens, some of them also may generate opportunities for consumers to improve their credit position and qualify for more-attractive credit terms. The credit-score disclosure and the new risk-based pricing notice — if implemented to help consumers without burdening the industry — could help lenders and brokers educate their customers about the importance of checking their credit records before they begin the loan-application process.

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