Regulatory Watch

Federal Trade Commission

FTC's Risk-Based Pricing Rule Kicks In On January 1

On December 22, 2009, the Federal Trade Commission (FTC) and Federal Reserve Board (Board) jointly released final rules, effective on January 1, 2011, which require "creditors" to provide a notice when, based on the consumer's credit report, the consumer will receive credit on less favorable terms than that provided to other consumers. The notice is intended to alert consumers to obtain a free credit report and check for potentially inaccurate or negative information in it. The FTC and the Board also issued model notice forms, which are optional, but any creditor using a model form receives a safe harbor for compliance. **Fair Credit Reporting Risk-Based Pricing Regulations, 75 *Fed. Reg.* 2724 (Jan. 15, 2010) (to be codified at 16 C.F.R. Parts 640 & 698) (Rule).**

As explained in the Rule's *Federal Register* notice, risk-based pricing is "the practice of setting or adjusting the price and other terms of credit offered or extended to a particular consumer to reflect the risk of nonpayment by that consumer."

Who Must Give Notice? Under the Rule, creditors must provide a written notice to certain consumers who are receiving "material" terms of credit that are "materially less favorable than the most favorable material terms available to a substantial proportion of consumers" from that creditor. In simple terms, a creditor using consumer reports to set the terms of credit must provide notice to those consumers receiving credit on terms less favorable than those offered by the same creditor to other consumers with better credit histories. Such terms include an interest rate or the amount of a security deposit.

Who Receives Notice? Generally, only consumers seeking credit primarily for "personal, family, or household purposes" that receive less favorable terms based on the creditor's use of consumer reports. The Rule does not apply to those receiving commercial or business credit. Guarantors, co-signers, sureties or endorsers also do not receive the notice. If there are "co-borrowers" (such as a husband and wife making a joint application), then only one notice is required if the co-borrowers reside at the same address.

The Rule provides for three alternative methods for determining which consumers receive the notice if done other than by a "direct comparison" of each consumer to the terms offered to others. These alternatives largely are directed at credit card and finance companies that offer credit to very large populations and/or offer an array of varying terms or tiers of credit.

When Is Notice Provided? Generally, notice must be provided before the transaction is consummated, but not before the creditor's decision to approve an application for, or a grant, extension, or other provision of, credit is communicated to the consumer.

What Must the Notice Say? The Rule enumerates eight statements that must be included in the notice: (1) a consumer report includes information about a consumer's credit history; (2) the terms offered have been set based on information in the report; (3) the terms may be less favorable than those offered to others with better credit histories; (4) encouragement to the consumer to check the accuracy of the information in the report and informing the consumer of the ability to dispute any inaccurate information; (5) identification of the consumer reporting agency (CRA) that furnished the report; (6) federal law gives the consumer the right to obtain a copy of their report from the CRA free for 60 days after receiving the notice; (7) information on how to obtain a consumer report from the CRA, including the CRA's contact information; and (8) directing consumers to the FTC and Board web sites for more information about consumer reports. Creditors may also elect to use a model form, and if they do, will be deemed to have complied with the Rule.

Are There Exceptions? Yes, there are, including an exception from providing the risk-based pricing notice if the creditor is providing an adverse action notice to the consumer.

EDITOR'S NOTE: *Many electric cooperatives use credit reports (often indirectly through a service provider's rating system based at least in part on a consumer's credit report) to determine whether to charge and/or the amount of a security deposit. Some cooperatives that offer consumer financing programs (e.g., low interest loans for water heaters, etc.) also use credit reports or ratings to determine consumer eligibility for financing. Under the FTC's interpretation of "credit," utilities are essentially viewed as extending credit when they provide*

service and then bill for it later. NRECA has discussed the risk-based pricing rule with some service providers and they are establishing mechanisms to enable their cooperative clients to generate the required notices.

Importantly, these notices as contemplated in the Rule will need to change. Section 1100F of the Dodd-Frank Wall Street Reform Act requires creditors to include a consumer's unique numerical credit score in a risk-based pricing notice as well as an adverse action notice (required by 15 U.S.C. § 1691(d) when credit is denied or cancelled on the basis of someone's credit report). These new Dodd-Frank requirements, codified at 15 U.S.C. §1681m, are to be implemented by July 21, 2011. The Rule's model forms do not provide for inclusion of a consumer's credit score. For cooperatives that do not receive the actual credit report or score, but rather just a service provider's rating, it is not clear at this point whether and how this new Dodd-Frank requirement would be met. The FTC and Board will need to revise the Rule and model forms before the July 21 deadline to reflect the Dodd-Frank amendments.

If you have questions or comments, please contact Tracey Steiner, NRECA Deputy Chief Member Counsel, at 703-907-5847 or tracey.steiner@nreca.coop.

Internal Revenue Service

IRS Indicates Some RUS and NTIA Broadband Grants Are Not Income

Through a revenue procedure effective September 23, 2010, the Internal Revenue Service (Service) provided a "safe harbor" for certain Rural Utilities Service (RUS) and National Telecommunications and Information Administration (NTIA) broadband grants under the American Recovery and Reinvestment Act of 2009, Public Law 111-5 (Act). In general, the Service will not challenge a corporation's treatment of these grants as nonshareholder contributions to capital and their corresponding exclusions from income. **Rev. Proc. 2010-34 (Sept. 23, 2010).**

Division A, title I of the Act appropriated $2.5 billion for broadband loans, loan guarantees, and grants authorized under the Rural Electrification Act of 1936. RUS administers this Broadband Initiatives Program (BIP). Similarly, division A, title II of the Act appropriated $4.7 billion for a Broadband Technology Opportunities Program (BTOP). NTIA administers the BTOP.

Under Internal Revenue Code (Code) § 118(a), a corporation's gross income does not include contributions to its capital. Under Treasury Regulation § 1.118-1, this exclusion applies to nonshareholder contributions to capital. Under Code § 362(c)(2), if a corporation receives money as a nonshareholder contribution to capital, then the basis of certain property is reduced by the contribution amount.

As indicated in the revenue procedure, the Service will not challenge a corporation's treatment of the following RUS BIP grants and NTIA BTOP grants, as nonshareholder contributions to capital: RUS last mile remote project grants, RUS last mile project grants, RUS middle mile project grants, RUS rural library broadband grants, NTIA broadband infrastructure grants, and NTIA comprehensive community infrastructure grants. The corporation, however, must properly reduce the basis of property under Code § 362(c)(2).

The revenue procedure, however, does not apply to RUS BIP satellite project grants, RUS BIP technical assistance grants, NTIA BTOP public computer center grants, or NTIA BTOP sustainable broadband adoption grants. Likewise, the revenue procedure does not apply to the portion of any grant paid to reimburse preapplication expenses, noncorporate taxpayers, RUS loans under BIP, or the Federal Communications Commission National Broadband Plan or Universal Service Fund.

EDITOR'S NOTE: *In general, a "cooperative" is usually considered a "corporation." A limited liability company, partnership, or similar entity, however, is not considered a "corporation."*

When determining whether a grant is a contribution to capital and excluded from "income" under the Code § 501(c)(12)(A) member income requirement, the Service often tracks Code § 118(a). While the revenue procedure does not directly address Code § 501(c)(12)(a), it seems it should apply to Code § 501(c)(12)(a). It appears, therefore, that the RUS and NTIA broadband grants treated as contributions to capital under the revenue procedure should be excluded from the 85 percent member income requirement of Code § 501(c)(12)(A).

If you have questions or comments, please contact Ty Thompson, NRECA Chief Member Counsel, at 703-907-5855 or tyrus.thompson@nreca.coop.

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